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The Structure of the Private Multinational Enterprise

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THE STRUCTURE OF THE PRIVATE MULTINATIONAL ENTERPRISE

Yitzhak Hadari

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THE STRUCTURE OF THE PRIVATE MULTINATIONAL ENTERPRISE

Yitzhak Hadari*

I. INTRODUCTION

FROM the beginning of the Industrial Revolution, society has experienced the persistent tendency of business organizations to expand. Businesses evolved from the rural workshop to the urban factory; from the municipal firm to the regional firm and then to the national enterprise. More recently, enterprises have expanded even further, from national firms with small export outlets to huge multinational enterprises (MNEs) embracing business operations all over the globe coordinated under a single management. Yet, along with its beneficial results for the peoples of the world, each new economic era brings with it new problems as well.

The conflict between the development of MNEs and the sovereign states in which they operate has generated a vast business literature¹ and has also commanded the attention of legal scholars.² This

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© Copyright 1973 Yitzhak Hadari. This is the first of two Articles on multinational enterprises. The concluding Article is still in preparation. These Articles are based on a doctoral dissertation submitted to The University of Michigan Law School. The remainder of the dissertation deals primarily with tax issues concerning the multinational enterprise. A small portion of the tax discussion provided the basis for an earlier Article, Hadari, *Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise*, 20 AM. J. COMP. L. 111 (1972).

The author wishes to thank Professors Eric Stein and Stanley Siegel of The University of Michigan Law School for their valuable comments and assistance. The author also wishes to thank The University of Michigan Law School for the generous support which enabled this study.

1. See, e.g., J. BEHRMAN, NATIONAL INTERESTS AND THE MULTINATIONAL ENTERPRISE (1970) [hereinafter J. BEHRMAN]; R. HELLMANN, THE CHALLENGE TO U.S. DOMINANCE OF THE INTERNATIONAL CORPORATION (1971); C. KINDLEBERGER, AMERICAN BUSINESS ABROAD (1969) [hereinafter C. KINDLEBERGER]; THE INTERNATIONAL CORPORATION (C. Kindleberger ed. 1970) [hereinafter INTERNATIONAL CORPORATION]; THE MULTINATIONAL CORPORATION IN THE WORLD ECONOMY (S. Rolfe & W. Damm ed. 1970) (collected papers presented at the Conference on Direct Investment in the Atlantic Area) [hereinafter S. Rolfe & W. Damm]; R. VERNON, SOVEREIGNTY AT BAY (1971) [hereinafter R. VERNON].

2. Angelo, *Multinational Corporate Enterprise*, 1968-III ACADÉMIE DE DROIT INTERNATIONAL, RECUEIL DES COURS 443 (1970) [hereinafter Angelo]; Fatouros, *The Computer and the Mud Hut: Notes on Multinational Enterprise in Developing Countries*, 10 COLUM. J. TRANSNATL. L. 335 (1971) [hereinafter Fatouros]; Goldberg & Kindleberger, *Toward a GATT for Investment: A Proposal for Supervision of the International Corporation*, 2 LAW & POLICY INTL. BUS. 295 (1970) [hereinafter Goldberg & Kindleberger]; Rubin, *Multinational Enterprise and National Sovereignty: A Skeptic's Analysis*, 3 LAW & POLICY INTL. BUS. 1 (1971) [hereinafter Rubin]; Vagts, *The Global Corporation and International Law*, 6 J. INTL. L. & ECON. 247 (1972); Vagts, *The*

Article does not deal with the socio-political and economic conflicts between these enterprises and sovereign states.³ Rather, its focus will be on the new legal dimensions sparked by the emergence of MNEs and the applicability of current legal concepts to their operations.

A thorough understanding of the structure and operation of these enterprises and their business attributes is a prerequisite to an analysis of the impact of a wide variety of laws on the MNE and to an appreciation of the challenges these enterprises provide for both national legal systems and the rules of public international law. Illustratively, scholarly preoccupation with such basic questions as the extraterritorial jurisdiction of nations⁴ may be misdirected as long as it ignores the new structural and operational attributes of MNEs. The business and legal structure of these enterprises is the key factor in the evolution of corporate, tax, and economic regulatory law, which ultimately will control the development of the MNE.⁵

Consequently, this Article will be devoted primarily to the establishment of a framework within which the impact and characteristics of the MNE may be considered. A second Article, currently in preparation, will then consider the applicability and validity of specific legal concepts to the MNE. Thus, rather than emphasizing orthodox concepts, these Articles will attempt to formulate new rules that will enable states to exercise effective control over vast MNEs while, at the same time, encouraging the development of the MNE as the most advanced instrumentality for promoting the well-being and increasing the standard of living of the peoples of all nations.

Multinational Enterprise: A New Challenge for Transnational Law, 83 HARV. L. REV. 739 (1970) [hereinafter Vagts].

3. For a discussion of these conflicts, see, in addition to literature cited in notes 1 & 2 *supra*, *Hearings on the Multinational Corporation and International Investment Before the Subcomm. on Foreign Economic Policy of the Joint Economic Comm.*, 91st Cong., 2d Sess., pt. 4 (1970) [hereinafter *MNE Hearings*]; *FOREIGN OWNERSHIP AND THE STRUCTURE OF CANADIAN INDUSTRY: REPORT OF THE TASK FORCE ON THE STRUCTURE OF CANADIAN INDUSTRY* (1968) [hereinafter *WATKINS REPORT*]. See also Litvak & Maule, *The Multinational Corporation: Some Economic and Political-Legal Implications*, 5 J. WORLD TRADE L. 631 (1971).

4. See, e.g., INTERNATIONAL LAW ASSOCIATION, REPORT OF THE FIFTY-FIRST CONFERENCE, REPORT OF THE COMMITTEE ON THE EXTRA-TERRITORIAL APPLICATION OF RESTRICTIVE TRADE LEGISLATION 348 (1964); Mann, *The Doctrine of Jurisdiction in International Law*, 1964-I ACADÉMIE DE DROIT INTERNATIONAL, RECUEIL DES COURS 1 (1964).

5. See Wells, *The Multinational Business Enterprise: What Kind of International Organization?*, 25 INTL. ORGANIZATION 447 (1971).

II. THE PRIVATE MULTINATIONAL ENTERPRISE IN PERSPECTIVE

A. *The New World Economy*

A new world economy is evolving primarily because of the internationalization of production.⁶ Its eventual structure and dimensions remain to be determined by political, governmental, and legal developments.⁷ It is apparent that "[a] startling and . . . new phenomenon ha[s] suddenly appeared on the economic horizon."⁸

As a result of foreign direct investment, global international production approximates 450 billion dollars, about one sixth of aggregate world production.⁹ This international production includes more than 200 billion dollars in output from investment activities in which American firms are engaged abroad and 100 billion dollars arising from foreign investments in the United States.¹⁰ The balance of 150 billion dollars represents international production by other countries not involving the United States.¹¹ Foreign direct investment is currently increasing at a rate of about ten per cent per year, exceeding the growth rate of most nations.¹² By the end of the century, this international, or multinational, output may well be equivalent to worldwide production that is not internationalized.¹³

It is no new phenomenon for the economic interests of nations to extend beyond their territorial boundaries. Nor do socio-political conflicts necessarily arise out of such across-the-border activities. But there are two important differences between previous investment activity and current developments.¹⁴ One is quantitative: the size and extent of the ownership of foreign assets surpass previous experiences. The second is qualitative: today, the principal medium through

6. Rolfe, *The International Corporation in Perspective* [hereinafter Rolfe], in S. Rolfe & W. Damm, *supra* note 1, at 6.

7. *Id.*

8. *Id.*

9. *MNE Hearings*, *supra* note 3, at 770 (Statement of Judd Polk, United States Council, International Chamber of Commerce).

10. *Id.*

11. *Id.*

12. Polk, *The New World Economy*, 3 COLUM. J. WORLD BUS., Jan.-Feb. 1968, at 7-8 [hereinafter Polk].

13. *MNE Hearings*, *supra* note 3, at 770 (Statement of Judd Polk). However, caution is warranted. There are insufficient data available to evaluate fully this new phenomenon, and not all of the data presently available are sensitive to the emergence of the new world economy. See Roback & Simmonds, *International Business: How Big Is It—The Missing Measurements*, 5 COLUM. J. WORLD BUS., May-June 1970, at 6 [hereinafter Roback & Simmonds].

14. Vernon, *Multinational Enterprise and National Security*, 74 ADELPHI PAPERS 1 (1971) [hereinafter *National Security*].

which foreign assets are accumulated is the MNE, an enterprise with headquarters in the home country (the base country or the investing country) that maintains operating units in foreign countries (the host countries).¹⁵ Investments by MNEs differ from traditional international investments because "[t]hose of the multinational enterprise are directed and managed day to day according to some business strategy which links those assets to others all over the globe."¹⁶

This second distinction has had particularly important ramifications for well-established principles of international trade. As one commentator has noted, the traditional theory of comparative advantage assumed

that while products move internationally, factors of production generally do not

The classical doctrine furnished a most powerful support for liberalizing national trade policies, and this policy is no less important in our day than it was in the last century. But in all honesty we must shift our emphasis from a theory that argues the benefits of international trade to one which focuses on how to obtain an optimum international allocation of resources in a world in which productive factors—especially capital—move with considerable ease among nations whose governments are by no means reconciled to the phenomenon.¹⁷

In economic terms, "[n]o use of resources is justified if the output can be achieved at a lower cost elsewhere."¹⁸ Thus, it has been noted that United States production abroad results from the interaction of American management and financing with foreign factors of production through the business network of the MNE.¹⁹ The output of these combined efforts must be considered as international or multinational production.²⁰

15. See text accompanying notes 57-66 *infra* for a discussion of the business definition of the MNE and text accompanying notes 146-60 *infra* for the legal definition. Although this Article is directed to private enterprises, see note 147 *supra* and C. FLIGLER, *MULTINATIONAL PUBLIC ENTERPRISES* (1967) [hereinafter C. FLIGLER] for a discussion of multinational public enterprises (some of which are called consortiums).

16. *National Security*, *supra* note 14, at 1. This is a large step beyond the days when foreign assets were primarily represented by pieces of paper issued by governments and economic institutions acknowledging the right of the holder to receive funds from the issuer, *id.*

17. Polk, *supra* note 12, at 8-9. See *MNE Hearings*, *supra* note 3, at 794-813 (Statement of John Dunning, Professor of Economics, University of Reading) for a discussion of the net economic effect of investments by MNEs.

18. *MNE Hearings*, *supra* note 3, at 796 (Statement of Judd Polk). The major arguments against this economic statement are political in nature, including questions of national security. See *National Security*, *supra* note 14.

19. Polk, *supra* note 12, at 9.

20. *Id.*

The traditional concept of international trade with its theoretical framework—including legal concepts and norms—does not fully cover the realities of the emergence of the MNE. One particularly striking feature of the “new economy” is that “[c]ountries do not export, firms do.”²¹ MNEs export mainly through intraenterprise transactions across national borders.²² Thus, even the comparison between international production and international trade is no longer fully meaningful since much exporting consists of intercompany sales among different national components of a single MNE.

One commentator has noted that “the volume of goods and services resulting from international investment has bypassed exports, and its present growth rate is considerably larger than that of international trade, thus making international investment the major channel of international economic relations.”²³ Foreign direct investment may be quite beneficial to the world, for it may culminate in the expansion of total world investment and production. The MNE promotes economic integration and a better allocation of resources on a global basis.²⁴

B. *The Development of the Modern Private Multinational Enterprise*

1. *Historical Evolution*

International corporate activity is not a recent development, but rather the latest step in a well-established economic process. International firms have advanced through various distinctive stages. The first was the commercial-and-banking era, which dates back to the thirteenth century when several trading firms based in Italy maintained branches in other European countries.²⁵ This era, extending from the Middle Ages and the Renaissance through the age of the great explorers to the mid-nineteenth century, included such famous participants as the Medicis at its beginning and the Rothchilds at its end. The second stage was the exploitative era, extending from about 1850 to the years just prior to World War I.²⁶ During this period,

21. Roback & Simmonds, *supra* note 13, at 19.

22. This creates the possibility that the MNE will distort the allocation of income and expenses to minimize its taxes through manipulation of transfer prices. *See* text accompanying notes 301-14 *infra*. Cf. INT. REV. CODE OF 1954, § 482; Treas. Reg. § 1.482-1 (1962), § 1.482-2 (1968).

23. Recommendations and Summary, S. Rolfe & W. Damm, *supra* note 1, at 107.

24. *Id.*

25. *See* E. KOLDE, INTERNATIONAL BUSINESS ENTERPRISE 222 (1968) [hereinafter E. KOLDE].

26. *Id.* at 222-23.

investment abroad was motivated by the need to secure reliable sources of raw materials for the developing industrial revolution. Interest turned away from the exotic products that had characterized much of the earlier commercial period and focused instead on industrial products such as minerals and ores. This, in turn, led to the expansion of colonial rule as countries sought to protect their investments. The third stage, the concessionary era, extending from the pre-World War I period to the end of World War II, was characterized by long-term concession agreements and the decline of colonial regimes. The fourth and current stage, to be examined in this Article, is the international-manufacturing era that is presently dominated by American firms.²⁷

The uniqueness of the modern MNE is suggested by its dramatic contrast with the colonial enterprises of the exploitative era in terms of economic patterns as well as legal and political dimensions. National governments granted the giant colonial companies the exclusive right to trade with a particular colony and to exercise the political powers of the state within that colony. These were not only monopolistic companies but, in Maitland's phrase, they were "[t]he companies that became colonies, the companies that make war."²⁸ These enterprises exploited the colonies to provide raw materials for the home countries for further manufacture and trade. The companies were immune from the import-export laws such as customs duties, and possessed the power to control international trade. They were authorized to tax the colonies, to decide disputes, and to defend themselves against pirates and other enemies; thus they fulfilled the range of governmental functions. Unlike the modern MNE, these colonial companies were not integrated into the local economy but remained economically and socially isolated. As a result, most of the beneficial effects of their activities accrued to the mother country.

The forerunner of the modern MNE had its origins in the late nineteenth and early twentieth centuries. A notable and early ex-

27. See *id.* at 221; R. ROBINSON, *INTERNATIONAL BUSINESS POLICY* 1-44 (1964); M. WILKINS, *THE EMERGENCE OF THE MULTINATIONAL ENTERPRISE* (1970); Hawrylyshyn, *The Internationalization of Firms*, 5 J. WORLD TRADE L. 72 (1971) [hereinafter Hawrylyshyn]; Rolfe, *supra* note 6, at 17.

28. Maitland, *Introduction to O. GIERKE, POLITICAL THEORIES OF THE MIDDLE AGES* xxvii (F. Maitland transl. 1913). The British East India Company, the Dutch East India Company, the Levant Company, the Hudson Bay Company, and the Massachusetts Bay Company were among the more prominent of these companies. See generally P. ELLSWORTH, *THE INTERNATIONAL ECONOMY* 33 (1964); 8 W. HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 200-12 (1937); J. MILL, *THE HISTORY OF BRITISH INDIA* (5th ed. 1858) (containing an elaborate history of the East India Company).

ample was created when the British Lever Brothers Company merged with the Dutch group Margarine Unie to form what is now the MNE known as Unilever.²⁹ Lever Brothers acquired facilities for local manufacturing and distribution in foreign countries. This was the beginning of a multinational structure, and Lever Brothers' successors developed it into a truly multinational enterprise, which now operates in some sixty countries and comprises some 500 companies.³⁰ Until World War II, there were very few MNEs based in the United States.³¹ The bulk of these American-based transnational activities were centered in the petroleum and mining industries.³²

2. Foreign Investment

The international flow of capital assumes many forms, including private direct business investment, private portfolio investment,³³ private long-term export credit, financial assistance by national governments of intergovernmental business organizations, and governmental direct investments.³⁴ The MNE operates as the main conduit for the flow of private direct business investment.

Direct investment differs from other types of international capital movements because it is accompanied by varying degrees of control, technology, and management.³⁵ International direct investment involves not only capital movement, but also capital formation through borrowing abroad in the local or multinational markets or by exchanging tangible or intangible property for equity rights—without exchanging funds through foreign capital markets. Direct investment

29. See E. KOLDE, *supra* note 25, at 226.

30. *Id.* Following Unilever's example, other European-based MNEs emerged, such as Royal Dutch-Shell, Philips, Imperial Chemical International, and Nestlé.

31. *Id.* Several direct investments in Canada, however, have their origin in the nineteenth century, of which du Pont and Edison (later known as the Canadian General Electric Company) were among the first. H. MARTYN, *INTERNATIONAL BUSINESS* 29 (1964).

32. E. KOLDE, *supra* note 25, at 226.

33. Private portfolio investment is the ownership of foreign stocks and bonds primarily for the return on investment rather than as a medium for active participation in the management of the foreign corporation. E. KOLDE, *supra* note 25, at 219.

34. This mode of capital flow can take the form of an enterprise that is owned by a government or by several governments and engages in activity in several countries. It carries out business activities similar to those performed by private enterprises. There are also mixed governmental-private direct foreign investments, some of which assume the main attributes of private investments such as the Scandinavian Airline System. See Angelo, *supra* note 2, at 471. Although these entities have sometimes been referred to as MNEs or multinational corporations, they are beyond the scope of this Article.

35. E. KOLDE, *supra* note 25, at 219. See C. KINDLEBERGER, *supra* note 1, at 1.

may also take place through the reinvestment of profits.³⁶ Thus, it is no surprise to find that foreign direct investment controls³⁷ have had less impact on the MNE's investments than experience with foreign investments prior to the modern MNE might have suggested. Such controls may seriously curb the flow of capital into or out of a country, and even the use of profits retained abroad for reinvestment, but they do not prevent raising money abroad through international or multinational financial markets.³⁸

Jean-Jacques Servan-Schreiber's *The American Challenge* directed the attention of the world to the development of the MNE when he proclaimed that within fifteen years the world's third-largest producing unit behind the United States and the Soviet Union may not be

36. C. KINDLEBERGER, *supra* note 1, at 2-3. Illustratively, the book value of United States direct investment abroad increased by 7.1 billion dollars in 1970. This increase was partially financed by reinvested earnings of United States-owned foreign corporations that totaled 2.9 billion dollars in 1970. Outflows of direct investment capital totaled 4.4 billion dollars in 1970, out of which 2.9 billion dollars was borrowed abroad by United States corporations; only 1.5 billion dollars was raised in the United States. On the other hand, the United States share of earnings, fees, and royalties from foreign subsidiaries and affiliates totaled 10.8 billion dollars. Statistics based on U.S. DEPT. OF COMMERCE, SURVEY OF CURRENT BUSINESS (Oct. 1971) [hereinafter SURVEY].

37. An example in point is the Foreign Direct Investment Regulations, Exec. Order No. 11,387, 15 C.F.R. §§ 1000.101-1405 (1972), 1972 Gen. Bull., 37 Fed. Reg. 18,294 (1972). Three schedules of countries were established, each with different percentages of permitted outflow and required remittances of earnings abroad. 15 C.F.R. § 1000.319 (1972).

38. See *MNE Hearings*, *supra* note 3, at 881 (Testimony of Robert Stobaugh, Associate Professor of Business Administration, Harvard University). See also *id.* at 764 (Testimony of James W. McKee, Jr., President of CPC International, Inc.). Mr. McKee stressed that "[a]lthough most large U.S. multinational corporations have been able to make their peace with these controls and have continued to grow abroad, there is no question that they have had a distorting and limiting influence." The MNEs had to borrow funds in the Euro-dollar markets and local markets abroad. They have been able to find the funds abroad, although this process has slowed down the rate of investment and has increased interest costs, which in turn have reduced the profitability of the investments. American borrowing in Europe increased from 500 million dollars in 1959 to almost 3 billion dollars in 1969. Jean-Jacques Servan-Schreiber noted that "[t]he multinational American corporations . . . are investing our own funds in their own development." *Id.* at 932. See note 36 *supra* for the 1970 investment figures. See also Barovick, *United States Firms Have Learned To Live with the OFDI*, BUSINESS ABROAD, July 7, 1971.

A competing "Asia-dollar" market, centered primarily in Singapore, is growing at a rapid pace. Many major American banks are opening branches there and are accepting dollar deposits from throughout Asia. Although the market has been developing only since 1968, nonresident United States-dollar deposits in Singapore jumped from 400 million dollars early in 1971 to 900 million dollars by the beginning of 1972. Although still tiny as compared to the Euro-dollar market, the infant Asia-dollar market's potential for growth is thought to be enormous. Asia-dollar deposits are forecast to reach 2 billion dollars by the end of 1973, although further growth might be more difficult. See THE ECONOMIST, Jan. 8, 1972, at 62. See also, Martin, *Here Comes the Asia Dollar*, FINANCE, Jan. 1971, at 34; FAR EASTERN ECON. REV. Y.B. 1971, at 87.

Europe, but American industry in Europe.³⁹ He further noted that the European Common Market was, in fact, American in organization.⁴⁰ The post-World War II period of direct international investment may indeed be termed the American era. While in 1946 American direct foreign investment amounted to only 7.2 billion dollars, by the end of 1971 that figure was 86 billion dollars, more than the combined direct foreign investment of the rest of the world.⁴¹

Capital movement, however, does not complete the picture of foreign investment abroad. Judd Polk concluded that the value of United States production abroad is twice that of American direct

39. J.-J. SERVAN-SCHREIBER, *THE AMERICAN CHALLENGE* 3 (1968).

40. *Id.* Mr. Servan-Schreiber, who is a Deputy of the French National Assembly and publisher of *L'EXPRESS*, stated more recently that the real value of American investment in the EEC stands close to 40 billion dollars. He stated that the American-based MNEs control ninety-five per cent of total production of integrated circuits—the basis of the electronics industry, eighty per cent of all electronic calculators and computers in Western Europe, and thirty per cent of the automobile business. Not only is the European industrial market thus dominated, but more recently the capital market has also become subject to American control, primarily through the Euro-dollar market. *MNE Hearings*, *supra* note 3, at 931-32 (Testimony of Jean-Jacques Servan-Schreiber). See REPORT OF THE ECONOMIC COMMITTEE OF EUROPEAN PARLIAMENT, Document 197, Feb. 2, 1970, at 26-30, for a table of the industrial and commercial penetration operations in the EEC in 1967. The massive extent of foreign (mostly American) investment in Canada is well known. About two thirds of the Canadian resource and primary manufacturing industries are controlled by foreigners, and approximately three fifths of her secondary manufacturing industry as well. *MNE Hearings*, *supra* note 3, at 915 (Statement of Melville Watkins, Professor of Economics, University of Toronto).

41. The statistics were compiled by the author from various issues of *SURVEY*, *supra* note 36. In these calculations, figures for direct investment have been obtained by adding the book value of equity to the long-term debt of foreign enterprises in which the American enterprise holds more than twenty-five per cent of the equity. If these book-value figures were adjusted to reflect current values, the result would be double or possibly triple the book-value calculation. See *MNE Hearings*, *supra* note 3, at 834, 836 (Statement of Jacques G. Maisonrouge, President, IBM World Trade Corp.). The table below, presenting the author's calculations, based on various issues of *SURVEY*, *supra* note 36, shows the United States direct investment abroad (year-end book value, billions of dollars):

	1929	1946	1950	1955	1960	1965	1970	1971
Total	7.5	7.2	11.8	19.3	31.9	49.4	78.1	86.0
Manufacturing	1.8	1.9	3.8	6.3	11.1	19.3	32.2	35.5
Petroleum	1.1	1.8	3.4	5.8	10.8	15.3	21.7	24.3
Mining & Smelting	1.2	1.1	1.1	2.2	3.0	3.9	6.2	6.7
Other Industries	3.4	2.4	3.5	5.0	7.0	10.9	18.0	19.5

The figures for 1970 are revised and those for 1971 are preliminary.

See J. VAUPEL & J. CURHAN, *THE MAKING OF MULTINATIONAL ENTERPRISE* 125 (1969) [hereinafter J. VAUPEL & J. CURHAN] for a table of the number of foreign manufacturing subsidiaries of 187 United States-controlled MNEs in selected years since 1901.

investment abroad.⁴² Furthermore, because international production has surpassed exports and has been increasing at a growth rate exceeding exports,⁴³ international production will continue to exceed exports in the world economy; "the primary channel to foreign markets is via foreign production rather than exports."⁴⁴ This trend "is underscored when it is recognized that a full 25 per cent of all U.S. exports are shipped within or to subsidiaries of U.S.-owned international corporations."⁴⁵ Confirming this phenomenon is the recent announcement by the EEC that in 1968 the sales of United States manufacturing subsidiaries operating within the European Common Market were almost four times the value of American exports of manufacturing products to the EEC and two and one-half times greater than total American exports to the EEC.⁴⁶ Despite some indications in 1968 that American direct investment in Europe was declining due to overcapacity,⁴⁷ statistics reveal that direct investment abroad by MNEs based in the United States continues to increase at an annual rate of ten per cent.⁴⁸

A very significant recent development has been the increase of European and Japanese direct investment abroad.⁴⁹ The value of foreign direct investment in the United States has risen by more than one half in just five years, from 8.8 billion dollars at the end of 1965 to an estimated 13.2 billion dollars at the end of 1970.⁵⁰ Since 1967,

42. Polk, *supra* note 12, at 8. Professor Sidney Rolfe observed: "This 2:1 ratio is a rule-of-thumb estimate but probably a pretty good one. Based on 1967 data, output in the vicinity of \$120 billion per annum resulted from U.S. direct investment of some \$60 billion." Rolfe, *supra* note 6, at 6. By way of comparison, the United States export figure for 1967 was only 30 billion dollars. On the basis of Polk's more recent estimate, the ratio appears to be even higher than 2:1. See text accompanying note 10 *supra*.

43. S. Rolfe & W. Damm, *supra* note 1, at 107. See Krause, *Why Exports Are Becoming Irrelevant*, 9 ATLANTIC COMMUNITY Q. 337 (1971). Krause expresses his view that the United States is passing out of the industrial age and becoming a service economy in which exports will become increasingly irrelevant.

44. Polk, *supra* note 12, at 8.

45. Rolfe, *supra* note 6, at 6. See text accompanying note 21 *supra*.

46. The sales of subsidiaries grew from 4.8 billion dollars in 1961 to 12 billion dollars in 1967, and to 14 billion dollars in 1968. EEC Information Service, Press Release, June 21, 1972, [New Developments] 2 CCH COMM. MKT. REP. ¶ 9510, at 9129 (1972).

47. *The Rush to Europe Slows to a Crawl*, BUSINESS WEEK, Aug. 3, 1968, at 82; INTERNATIONAL FINANCE, April 14, 1969.

48. See *MNE Hearings*, *supra* note 3, at 907 (Testimony of Stephen Hymer, Associate Professor of Economics, Yale University).

49. See Rhodes, *The American Challenge Challenged*, 47 HARV. BUS. REV., Sept.-Oct. 1969, at 45; Rolfe, *Updating Adam Smith*, INTERPLAY, Nov. 1968, at 15, 17.

50. SURVEY, *supra* note 36, Sept. 1967, at 518, Oct. 1971, at 38. In 1970 the value of foreign direct investment in the United States rose 1.4 billion dollars, following a rise of 1 billion dollars in 1969. A substantial portion was related to new acquisitions or increases in equity investments in a small number of United States corporations, *id.*, Oct. 1971, at 36. See also *Responding to Le Défi Américain*, FINANCE, Jan. 1971, at 30; Tracy, *A Big Foreign Stake in U.S. Industry (A Portfolio)*, FORTUNE, Aug. 1971, at 118.

the direct investment of European companies in the United States has for the first time increased at a greater rate than the direct investment of American-based corporations in Europe.⁵¹

The number of MNEs in the world varies according to the definition of the term employed. According to a recent estimate, there were about 200 American-based MNEs and fifty based in other countries in the manufacturing and extractive industries in 1969.⁵² Since the trend is toward larger and additional MNEs, "the free world faces a substantial shift in the ownership and control of industry from local nationals to foreigners."⁵³ Thus, in addition to economic consequences, this shift has an important political dimension: "Foreign control means the potential shift outside the country of the locus of some types of decision-making."⁵⁴ Europeans, for example, are emphasizing the need for political power, not to prevent the American-based MNEs from coming since they admit that the MNEs are beneficial, but rather as a means of exercising some form of control.⁵⁵

51. Hellmann, *The Challenge to U.S. Dominance of the International Corporation*, 9 ATLANTIC COMMUNITY Q. 76 (1971). France increased her world direct investment by approximately 300 per cent in the five years between 1962 and 1967, so that French investments abroad now equal foreign investments in France. A similar trend is shown by German and Swedish direct foreign investments. See Rolfe, *supra* note 6, at 9-12. German direct investment abroad increased from less than 1 billion dollars in 1961 to 3.6 billion dollars in 1968, Runderlass Aussenwirtschaft, No. 14/69 (German Dept. of Commerce, Bonn). British direct investment abroad tripled between 1961 and 1967, increasing from 1.3 billion dollars in 1961 to 3.8 billion dollars in 1967, and then to an estimated 4.9 billion dollars in 1968. (Statistics compiled by author from various issues of BOARD OF TRADE JOURNAL.) Japanese annual direct investment abroad increased from 92.4 million dollars in 1960 to 224 million dollars in 1967, with a total of 1.4 billion by March 31, 1968, JAPANESE WHITE PAPER ON ECONOMIC COOPERATION, quoted in Iwasa, *Japan Ventures into Southeast Asia*, 4 COLUM. J. WORLD BUS. 49, 51 (1969). The table below, compiled by the author from various issues of SURVEY, *supra* note 36, shows foreign investment in millions of dollars in the United States in recent years, employing the same assumptions as in note 41 *supra*.

	1963	1968	1969	1970 ^b
Total	7,934	10,815	11,818	13,209
Western Europe	5,481	7,750	8,510	9,515
EEC	1,728	2,790	3,306	3,528
Britain	2,265	3,409	3,496	4,110
Others	1,488	1,551	1,708	1,877
Canada	2,183	2,659	2,834	3,112
Latin America	112	182	193	228
Japan		181	176	233
Others	158 ^a	43	105	121

^a Japan is included in the "Others" category in 1963.

^b The figures for 1970 are preliminary.

52. J. BEHRMAN, *supra* note 1, at 10. See text accompanying notes 57-66 *infra* for a business definition of the MNE and text accompanying notes 146-60 *infra* for a legal definition.

53. J. BEHRMAN, *supra* note 1 at 10.

54. WATKINS REPORT, *supra* note 3, at 27.

55. See MNE Hearings, *supra* note 3, at 943 (Testimony of J.-J. Servan-Schreiber).

The conclusion is irresistible that all industrialized countries are sharing in the newly developing world economy, and, despite the post-World War II American era, there is no longer an American monopoly of MNEs. As one observer noted, "If European firms become more multinational, and if Americans continue to invest abroad, we will create a large number of North Atlantic corporations no longer tied specifically to any particular nation."⁵⁶

C. *A Business Definition of the Multinational Enterprise*

Not every large enterprise that engages in transnational business is truly "multinational." The term "multinational enterprise" and its business cognates do not refer to a narrowly defined business organization. Generally, the popular reference is to any big business with large across-the-border operations. Those analysts who have attempted more precise definitions encounter substantial difficulties, often resulting from conceptual misunderstandings or incomplete data.⁵⁷ As one authority has pointed out:

Multinational enterprises were born to utilize with ever increasing efficiency resources such as raw materials, capital, management and research. But how many of these corporations can rightly be called "multinational," and how many are instead merely large enterprises, which limit themselves to operation on various markets?⁵⁸

Since a precise, accepted definition of an MNE does not exist, it is necessary instead to enumerate the main factors that characterize such firms and hope thereby broadly to delimit it.

The major identifying criterion of the MNE is the implementation of a global strategy involving all the units of the enterprise and directed by a single top management.⁵⁹ This leads in turn to two distinctive features of an MNE. First, it transacts a sufficiently substantial amount of business abroad so that its financial status is dependent upon operations in several countries. Objective indications of an MNE include the proportion of assets, sales, production, and employment outside of the home country,⁶⁰ foreign affiliates, and

56. *MNE Hearings*, *supra* note 3, at 906 (Testimony of Stephen Hymer).

57. See Roback & Simmonds, *supra* note 13, at 6.

58. *MNE Hearings*, *supra* note 3, at 759 (Testimony of Guido Colonna di Paliano, Director, Fiat Corporation, and former Italian member of the EEC Commission).

59. "The best criteria would seem to be the horizons and strategy of the company rather than the share of assets or sales outside of the home country." Roback & Simmonds, *supra* note 13, at 10.

60. Such criteria are "biased by the size of the home-country economy and market," and therefore are not fully meaningful. Roback & Simmonds, *supra* note 13, at 10. Thus, a company based in a small country would tend to have a larger portion of its

distribution of equity by nationality.⁶¹ Second, "its management makes decisions on the basis of multinational alternatives."⁶² The subjective attitude of company executives must be evaluated in estimating the degree of "multinationality" of a firm. MNEs attempt to coordinate production and sales on a global basis, relying on foreign plants as alternative sources of supply and transferring components between the foreign affiliates and parent companies.⁶³ The Ford Motor Company declares: "It is our goal to be in every single country there is. Iron Curtain countries, Russia, China. We at Ford Motor Co. look at a world map without any boundaries."⁶⁴ Unilever states: "We want to Unileverize our Indians and Indianize our Unileverans."⁶⁵ A global orientation of the management toward the main problems and issues of the enterprise is a vital characteristic of an MNE.⁶⁶

D. *Are Multinational Enterprises Really "Multinational"?*

Some commentators have attempted to classify firms according to their degree of multinationality. The Canadian *Watkins Report* employs three terms to describe degrees of multinationality.⁶⁷ First, there is the "national firm," with relatively small foreign operations and "citizenship" in the home country alone. Second, there is the "multinational corporation," which "seeks to be a good citizen of

assets or sales outside of the country than a company in a larger country. *Id.* In addition, direct foreign investment data generally measure investments external to the home country whereas, in a true MNE, account should be taken of the investment at home as well as investment abroad. *Id.*

61. A study of the MNE by the Harvard Graduate School of Business chose corporations listed in *FORTUNE* magazine's "500 Largest U.S. Industrial Corporations" that own twenty-five per cent or more of the equity interest in manufacturing subsidiaries in six or more foreign countries. See generally J. VAUPEL & J. CURHAN, *supra* note 41, at 2-3; Fouraker & Stopford, *Organizational Structure and the Multinational Strategy*, 13 *ADMINISTRATIVE SCIENCE Q.* 47, 57 (1968) [hereinafter Fouraker & Stopford].

62. Steiner, *The Nature and Significance of Multinational Corporate Planning*, in *MULTINATIONAL CORPORATE PLANNING* 1, 6 (G. Steiner & W. Cannon ed. 1966) [hereinafter G. Steiner & W. Cannon].

63. *A Rougher Road for Multinationals*, *BUSINESS WEEK*, Dec. 19, 1970, at 58 [hereinafter *BUSINESS WEEK*]. For instance, "IBM Corp. links its laboratories in the U.S. and abroad with a data transmission network for continuous exchange of research findings. [Likewise] Ford builds Pinto engines in the United Kingdom and Germany for assembly into cars in the United States and Canada." *Id.*

64. *Id.* at 58, quoting Robert Stevenson, Executive Vice-President, Ford Motor Co.

65. Perlmutter, *The Tortuous Evolution of the Multinational Corporation*, 4 *COLUM. J. WORLD BUS.*, Jan.-Feb. 1969, at 9, 11 [hereinafter Perlmutter], quoting the Chairman of the Board of Directors of Unilever.

66. *Id.* at 9. While a recognition of these subjective elements is helpful in explaining the behavior of MNEs, it obviously cannot serve as a workable definition for an initial classification of firms as MNEs.

67. *WATKINS REPORT*, *supra* note 3, at 33.

each country in which it is operating"⁶⁸ and is sensitive to local traditions and policies.⁶⁹ Third, there is the "international or global corporation," which owes primary loyalty to no single country and makes decisions solely on the basis of corporate efficiency.⁷⁰ As might be expected from the kinds of distinctions sought to be made, there are no clear-cut lines separating these three classifications.⁷¹

Although "time, transnational mergers, management selection on a geocentric basis, and further financial crossovers"⁷² are likely to increase the multinationality of even the "national firm," most MNEs are still identified with their country of origin and thus are not yet fully multinational.⁷³ Only a few European MNEs have made strides toward complete multinationalization. Two early Anglo-Dutch examples are Royal Dutch-Shell and Unilever. More recently, the tie-up between Britain's Dunlop and Italy's Pirelli is a step toward full multinationalization,⁷⁴ as was the Agfa-Gevaert link-up in 1964 combining Belgian and German photographic production and marketing facilities, which previously had been separately owned and operated,⁷⁵ resulting in an MNE not identified with a single country.

68. C. KINDLEBERGER, *supra* note 1, at 180. Professor Kindleberger accepts the terminology of the *Watkins Report* in his study.

69. WATKINS REPORT, *supra* note 3, at 33.

70. Professor Perlmutter used very similar criteria, dividing the firms into (1) "ethnocentric or home-country oriented," a firm that is associated with the nationality of the headquarters; (2) "polycentric or host-country oriented," a firm with foreign subsidiaries that are associated with the local nationality; and (3) "geo-centric or world oriented," a firm that is not identified with any nationality. Perlmutter, *supra* note 65, at 11.

71. See Perlmutter, *supra* note 65, at 13; Vernon, *Economic Sovereignty at Bay*, 47 FOREIGN AFFAIRS 110, 114 (1968). For the problem of defining the MNE, see also R. BLOUGH, INTERNATIONAL BUSINESS: ENVIRONMENT AND ADAPTATION 8 (1966); E. KOLDE, *supra* note 25, at 218; S. ROLFE, THE INTERNATIONAL CORPORATION 8-16 (Study for the 22d Congress of the International Chamber of Commerce, Istanbul 1969) [hereinafter S. ROLFE]; Union of International Associations, *Multinational Business Enterprise*, in YEARBOOK ON INTERNATIONAL ORGANIZATIONS, 1968-1969; Angelo, *supra* note 2, at 469-79; Fatouros, *supra* note 2, at 326-31.

72. Rolfe, *supra* note 6, at 17.

73. "Multinational corporations have an address and a nationality, rhetoric and intentions notwithstanding, and what we should be talking about here are American corporations operating abroad . . ." MNE Hearings, *supra* note 3, at 911 (Statement of Melville Watkins).

74. This tie-up has faced major problems because of the continuing losses incurred by Pirelli. [Euromarket News] CCH COMM. MKT. REPORTS, No. 199, at 7 (Nov. 7, 1972).

75. See Le Page, *The European Merger—Agfa-Gevaert*, in INDUSTRIAL INTEGRATION IN EUROPE, PRACTICE AND POLICY 9 (Conference sponsored by the Federal Trust for Education and Research, March 1968). A direct merger in the legal sense is impossible under various European laws and would involve tremendous tax consequences even where permissible. Therefore, firms endeavor to create a transnational merger in the economic sense, while preserving legal separation. See notes 172-74 *infra* and accompanying text.

In a true MNE, the personnel should be interchangeable between the parent and the affiliate corporations, yet in most present day MNEs top management is composed of home-country managers.⁷⁶ Developing MNEs have moved further toward utilizing multinational strategies in the areas of financial and product planning than in personnel policies.⁷⁷ So far, MNEs have been hesitant to promote local managers to positions at corporate headquarters,⁷⁸ but there is reason to believe that, with growing maturity, MNEs will develop multinational personnel policies. The addition of managers from abroad has given a multinational appearance to the high-level management of several major MNEs.⁷⁹ This trend will continue as MNEs adopt policies aimed at attracting capable management on a global basis.⁸⁰

An enterprise that is truly multinational must be multinational in ownership as well; yet, as in the personnel area, this goal has not generally been reached. Several MNEs have increased the multinationalization of their sources of funds. Some MNEs have long used the stock markets in many countries, such as Shell, which is widely owned in the United States, the United Kingdom, the Netherlands, and France.⁸¹ Financial "crossovers" through the foreign buying of American corporate shares have also been increasing recently.⁸² General Motors believes that operation through worldwide wholly owned subsidiaries "facilitates unity, coordinated policy determination and sound operating procedures."⁸³ Therefore, GM encourages residents of host countries to buy the parent company stock on the same basis as it is made available to the people of the United States, without regard to the nationality of the shareholder.⁸⁴ Most large MNEs follow a similar policy,⁸⁵ and it is anticipated that the listing

76. See Perlmutter, *supra* note 65, at 12.

77. Rose, *The Rewarding Strategies of Multinationalism*, FORTUNE, Sept. 15, 1968, at 180 [hereinafter Rose].

78. *Id.*

79. BUSINESS WEEK, *supra* note 63, at 58. For instance, the President of IBM World Trade Corporation is a Frenchman. Likewise, the number two man and finance committee chairman at Black & Decker is an Englishman. As another recent example, Motorola announced the promotion of the manager of its Israeli affiliate to its international headquarters.

80. BUSINESS WEEK, *supra* note 63, at 58-59.

81. See S. ROLFE, *supra* note 71, at 107.

82. The ownership of securities of United States corporations by foreigners increased from 3 billion dollars in 1950 to 15 billion dollars in 1967, over 10 billion dollars of which is owned by Europeans. S. ROLFE, *supra* note 71, at 113.

83. F. DONNER, THE WORLD-WIDE INDUSTRIAL ENTERPRISE 106 (1967).

84. However, GM admits there are many obstacles raised by the world legal environment. *Id.* at 98-102.

85. See S. ROLFE, *supra* note 71, at 114-15.

of the parent's stock on foreign stock exchanges will continue to increase.⁸⁶ Furthermore, as a result of the capital-flow restrictions imposed by certain countries such as the United States⁸⁷ and the United Kingdom, the Euro-bond market, an unplanned and unregulated international capital market, has developed and has attracted corporate borrowers from both Europe and Japan.⁸⁸ Other innovations of international financial sources have followed, including the development of Euro-commercial paper.⁸⁹

While it is perhaps true that "[t]he aim of the multinational company is, quite forthrightly to become more completely multinational in terms of its people, its capital, and ownership,"⁹⁰ it is clear that most MNEs have not yet reached a stage even approaching complete multinationality.

III. ORGANIZATIONAL AND CONTROL STRUCTURE

A. *Organization of the Multinational Enterprise*

The main objective in the organization of an MNE is to maximize managerial efficiency. The organizational structure adopted should enable top management to exercise the desired degree of control over the various national entities and divisions of the enterprise.

A firm progresses through a series of organizational stages of multinationalization in its evolution into an MNE.⁹¹ Most manufacturing firms, for example, start by exporting their products abroad. To accommodate this new dimension of operations, the domestic

86. Vernon, *Multinational Enterprise and National Sovereignty*, 45 HARV. BUS. REV., March-April 1967, at 156, 166 [hereinafter Vernon].

87. The United States program, which was formerly voluntary, became mandatory by Executive Order on Jan. 1, 1968, see note 37 *supra*, and is controlled by the Commerce Department's Office of Foreign Direct Investments (OFDI).

88. S. ROLFE, *supra* note 71, at 113.

89. See, e.g., Ullman, *Euro-Commercial Paper and Its Legal Problems*, WORLDWIDE P & I PLANNING, Jan.-Feb. 1971, at 22. See note 38 *supra* for a discussion of the Euro-dollar and Asia-dollar markets.

90. MNE Hearings, *supra* note 3, at 763 (Statement of James W. McKee, Jr.).

91. See generally M. BROOKE & H. REMMERS, *THE STRATEGY OF MULTINATIONAL ENTERPRISE* 26-63 (1970) [hereinafter M. BROOKE & H. REMMERS]; BUSINESS INTERNATIONAL CORPORATION, *ORGANIZING THE WORLDWIDE CORPORATION* (1970) [hereinafter BUSINESS INTERNATIONAL]; E. KOLDE, *supra* note 25, at 245-58; STIEGLITZ, *ORGANIZATIONAL STRUCTURES OF INTERNATIONAL COMPANIES* (1965); D. ZENOFF, *INTERNATIONAL BUSINESS MANAGEMENT* 259-65 (1971) [hereinafter D. ZENOFF]; Clee & Sachtjen, *Organizing a World-Wide Business*, 42 HARV. BUS. REV., Nov.-Dec. 1964, at 55 [hereinafter Clee & Sachtjen]; Fouraker & Stopford, *supra* note 61; Hawrylyshyn, *supra* note 27, at 81; BUSINESS WEEK, *supra* note 63, at 64; Rose, *supra* note 77, at 103.

organizational structure includes an export department; the firm may be described as "foreign oriented"—type *A*.⁹²

As the volume of sales abroad increases, the export department is no longer capable of handling international sales. Distribution operations and limited manufacturing operations are established abroad, thereby increasing the degree of multinationalization. To replace the export department, an international division or an international headquarters company is established to control all foreign operations; this may be termed the type *B* firm.⁹³ The international division is therefore "an independent profit center" on an equal basis with the domestic product division.⁹⁴

As the volume of business abroad continues to increase, a broader range of manufacturing operations is undertaken abroad. Often the firm sets up research and development facilities in foreign countries. To avoid conflicts between the profit responsibility of the international operations and the global management of the enterprise,⁹⁵ some MNEs have adopted "a product-oriented organization, [placing] executives in charge of product divisions on a world-wide basis."⁹⁶ This may be termed the type *C* enterprise. Foreign and domestic operations are carried on the same set of books in the product division, and sales opportunities are sought on a global basis—subject only to the restrictions imposed by the sovereign nations involved. Thus, under the type *C* structure, the MNE has much greater coordination between its domestic product divisions and its foreign marketing operations.⁹⁷

The type *C* enterprise may choose a different organizational structure. Instead of product divisions, the company may divide the former international division into marketing-oriented geographical divisions;⁹⁸ senior executives are then assigned various areas of the world, domestic as well as foreign, while a worldwide top manage-

92. See E. KOLDE, *supra* note 25, at 244.

93. Hawrylyshyn, *supra* note 27, at 81. See D. ZENOFF, *supra* note 91, at 262, for a diagram of the international division structure of a type *B* company.

94. Rose, *supra* note 77, at 103.

95. For instance, top management might find it difficult to make global price adjustments on intercompany transactions. See text accompanying notes 301-14 *infra* for a discussion of intercompany transactions.

96. Hawrylyshyn, *supra* note 27, at 81.

97. See, e.g., BUSINESS WEEK, *supra* note 63, at 140 (discussion of the reorganization of Rockwell Manufacturing Co.); text accompanying notes 137-45 *infra* (discussion of Sperry Rand). See also R. VERNON, *supra* note 1, at 125-40.

98. See Clee & Sachtjen, *supra* note 91, at 60-62.

ment oversees the geographical divisions.⁹⁹ Some MNEs establish a functional type *C* organization, in which financial and marketing executives exercise global responsibilities.¹⁰⁰ Other MNEs set up a hybrid structure of worldwide product divisions within geographical areas, especially when consumer products are involved;¹⁰¹ indeed, some enterprises even retain the international division or international corporation.¹⁰² By carefully structuring its organizational format and by adopting worldwide approaches,¹⁰³ the MNE can avoid conflicts between the domestic product divisions and the international divisions.

Operations abroad may be conducted through either a foreign subsidiary or a branch. While a multitude of variables, both corporate and legal, determines in a particular instance whether a company will choose the subsidiary or branch form, identifiable trends have emerged in particular industries. Most marketing-oriented American-based MNEs operate abroad through subsidiaries and affiliates, while many service corporations (particularly banks and advertising agencies) and firms in extractive industries operate through branches.¹⁰⁴ The majority of American affiliates abroad have been wholly owned by the parent corporation or other affiliates of the same MNE.¹⁰⁵ Occasionally, a regional center is established between the foreign subsidiary and the parent company. The regional center facilitates coordination of the activities of local corporations in a group of countries. The center is regarded as an extension of the headquarters that has moved closer to the foreign operations.¹⁰⁶ While this coordination is particularly necessary in marketing operations, leading some firms to rely entirely on regional marketing centers, regional centers have also been used to facilitate financial coordination¹⁰⁷ or to take advantage of favorable tax treatment in "tax haven" countries.¹⁰⁸

99. *Id.* at 61.

100. D. ZENOFF, *supra* note 91, at 262.

101. *See* Clee & Sachtjen, *supra* note 91, at 62.

102. *See* E. KOLDE, *supra* note 25, at 252, for a diagram of the functional type *C* organizational structure; D. ZENOFF, *supra* note 91, at 263-64, for diagrams of product-oriented type *C* structure and the geographically decentralized type *C* structure.

103. *See* Fouraker & Stopford, *supra* note 61.

104. D. ZENOFF, *supra* note 91, at 190.

105. *Id.*

106. M. BROOKE & H. REMMERS, *supra* note 91, at 43-44.

107. *Id.* at 45.

108. *But see* text accompanying notes 168-71 *infra*.

B. Control Within the Multinational Enterprise

One of the major problems faced by the developing MNE is the necessity of allocating control over foreign operations. In general terms, MNEs tend to centralize control of basic strategies in order to operate in the most efficient manner and to exploit opportunities on a worldwide basis; such coordination is vital because their multiple affiliates operate in potentially overlapping markets. The MNE can organize the interchange of products and components on a multinational basis. For example, through its affiliates Massey-Ferguson combines "a French-made transmission, a British-made engine, and a Mexican-made axle constructed with American-made sheet metal parts to produce a tractor in Detroit that will be sold in Canada."¹⁰⁹ MNEs are quite distinct from solely domestic enterprises in the sophistication of control necessary to operate efficiently.

Even the strategy utilized to achieve comprehensive control must be multidimensional. Authority over decisions in the diverse areas of marketing, finance, and production must be allocated not only between various levels of management, but also among the available locations on any given level. In the true MNE, management appreciates that strategic choices between domestic and foreign markets are closely interrelated.¹¹⁰

The control dimension of the MNE distinguishes it from the domestic firm. A subsidiary of an MNE in a foreign country does not necessarily behave in the same way as its "competitor," a domestic firm in the host country operating under the same market conditions. They may operate differently and still be rational in their efforts to maximize profits. The domestic corporation is by definition national, usually smaller, and maximizes income on a short-term basis in the domestic market context, whereas the MNE operates in a world environment and maximizes profits on a long-term basis.¹¹¹

The separation of control from the situs of the subsidiaries or affiliates raises some difficult political as well as business and legal problems for the MNE. Political disputes occur when governments attempt to implement national economic policies through MNEs based within their jurisdiction, while countries in which the subsidiaries and affiliates of the MNE are operating resist those policies. Thus, it is difficult to reconcile an asserted right of the home coun-

109. Rose, *supra* note 77, at 104.

110. See, e.g., Weisglas & Coope, *Planning in Unilever with Special Reference to the Common Market*, in G. Steiner & W. Cannon, *supra* note 62, at 223.

111. C. KINDLEBERGER, *supra* note 1, at 5.

try to require the parent company to direct its global subsidiaries to act in accordance with national policies, with the similar right of the host country to require that subsidiaries operating within its jurisdiction obey its own divergent policies. At the same time, the host country may even attempt to regulate the operations of the parent company in the home country. This leads to inevitable friction between nations, with the MNE as the potential victim of the conflict. This conflict is illustrated by the various criteria that nations use to define their jurisdiction over MNEs in determining the nationality, domicile, or residence of enterprises for a range of legal purposes including conflicts of laws, taxation, antitrust laws, balance of payments regulation, and export controls.¹¹²

Ascertaining the location of control for legal and business purposes is very difficult and is not subject to rigid rules. The location of operating control varies significantly from one MNE to the next, and is largely dependent on the strategy of control selected. Interestingly, a case can be made for both general control theories: centralization of decision-making at the headquarters level, and decentralization of control at the subsidiary or affiliate level.

The greater proximity of a foreign subsidiary to product markets argues persuasively for delegation of tactical decision-making from the parent corporation to the subsidiary. This increased sensitivity to local conditions makes the subsidiary the logical locus for marketing decisions and strategic planning.¹¹³ As a general proposition, marketing-oriented firms have a more decentralized control structure. Yet, even in those firms there are certain areas in which a coordinated and centralized managerial control system may be compelled. Thus, close supervision by the parent is generally found over aggregate production plans, tax and antitrust strategy, and relations between the MNE and the host governments.¹¹⁴ Still other firms may centralize on a broader basis, particularly those with a technical orientation,¹¹⁵ and, when most of the relevant knowledge, skill, or resources are at company headquarters, there is a tendency to centralize.¹¹⁶ One MNE, "which sees itself as being at once centralized and decentralized, feels that it operates in three dimensions: a global dimension of central policy making, strategy and research; a continental dimension of manufacturing and management development; and a national dimen-

112. See text accompanying notes 315-29 (tax), 348-68 (antitrust) *infra*.

113. See R. ROBINSON, *INTERNATIONAL MANAGEMENT* 156 (1967).

114. *Id.*

115. See *BUSINESS INTERNATIONAL*, *supra* note 91, at 5.

116. *Id.* at 42-47.

sion of marketing, treasury, and personnel."¹¹⁷ Some enterprises delegate authority to a regional center. The regional center, when one exists at all, can be used as a "post office for messages in transit or as an important decision-making unit."¹¹⁸

It is difficult to conclude that control generally is being either centralized or decentralized. Not long ago, decentralization seemed to be prevailing in international business, but at a later stage there were indications of a shift to a greater degree of centralization.¹¹⁹ Centralization permits more definitive and pervasive policies for long-range planning in terms of international markets.¹²⁰ Developments such as "worldwide and regional economic integration, increasing competition on a multinational basis, [and] . . . the rapid development of faster communication systems and transportation media" have provided further incentive to centralize.¹²¹ Just recently, however, signs of decentralization have again appeared as the size of foreign interests and operations of firms has continued to grow, thereby making centralization less manageable and efficient.¹²² Thus, much decision-making authority has been delegated back to the foreign subsidiaries or regional headquarters.¹²³

If any generalization about the forms and trends of control in MNEs is possible, it is only that the location of control must be ascertained on a case-by-case basis. Governments desiring to control the business operations of MNEs must direct their legal commands to that component of the MNE that is empowered to respond—the place where the effective control lies with respect to the *particular issue* under consideration. Nations must look at the entire corporate network of the MNE in order to determine where the particular authority resides, and they must consider whether addressing directives to local affiliates will achieve the desired policy objectives.

117. *Id.* at 5.

118. M. BROOKE & H. REMMERS, *supra* note 91, at 125.

As a firm's international operations expand and become a more significant determinant of its financial status, enterprises begin to recognize the need for a high quality communications system. Yet, the communications system designed may vary according to the purpose sought to be achieved. When communication is desired for decision-making purposes, it is, of course, necessary to assure that the communications channels mirror the established organizational decision-making chain. But when, by contrast, the communications system is established for informational purposes only, it need not track the organizational system precisely. BUSINESS INTERNATIONAL, *supra* note 91, at 5.

119. *Id.* at 68.

120. *Id.*

121. *Id.*

122. R. VERNON, *supra* note 1, at 132.

123. *Id.*

National policies may well be frustrated if states treat a local affiliate of an MNE as a wholly independent entity without regard to the actual location of authority and control over the particular subject matter sought to be regulated.¹²⁴

C. *Illustrations of Organizational and Control Structure
of Multinational Enterprises*

The utilization of these organizational and control techniques can be illustrated by examination of two MNEs that have adopted widely divergent systems of operation: IBM World Trade Corporation and Sperry Rand.¹²⁵

Despite the fact that the international company or departmental structure is generally employed by a type B firm,¹²⁶ many MNEs continue to use it. A leading example is IBM, which operates abroad through its IBM World Trade Corporation (World Trade), a wholly owned domestic subsidiary.¹²⁷ World Trade maintains controlled decentralization of responsibility on a regional basis.¹²⁸

The control structure of World Trade clearly documents the general control patterns discussed above.¹²⁹ Marketing operations are decentralized in order to maximize sensitivity to local customer demands. But, because World Trade's technology is quite advanced and rapidly changing, product development and research are coordinated globally, thereby establishing a link not only between the subsidiaries within World Trade, but also maintaining operating ties between the domestic parent and the foreign operations.¹³⁰

World Trade's line structure is geographical.¹³¹ Foreign business in 106 countries is divided among four areas, two of which are fur-

124. The EEC Court of Justice adopted this approach in its recent *Dyestuff* decisions. See text accompanying notes 354-68 *infra*.

125. The discussion of the structure of IBM and Sperry Rand is based on BUSINESS INTERNATIONAL, *supra* note 91, at 13-17, 26-28.

126. See text accompanying notes 93-94 *supra*.

127. BUSINESS INTERNATIONAL, *supra* note 91, at 12-13.

128. *Id.*

129. See text accompanying notes 113-17 *supra*.

130. BUSINESS INTERNATIONAL, *supra* note 91, at 14:

[P]roduct development and manufacturing are centrally assigned to various specialized development laboratories and plants throughout the world. Under this system each development laboratory is highly specialized in a particular technology and each plant manufactures a specific range of products for the local market and for export. This creates an interdependence among foreign and domestic plants.

The laboratories and plants are owned by the company operating in the country in which they are located, and they report to that company.

131. *Id.* at 15, 17.

ther divided into two regions.¹³² The top officers of the areas are responsible to the president of World Trade.¹³³ Within a given area, management is further subdivided on a geographical basis.¹³⁴ World Trade "has delegated major operational responsibility to the country level."¹³⁵ Many decisions, principally in the areas of "financing requests, external government contracts, engineering and manufacturing coordination, . . . and final approval of plans and budgets"¹³⁶ are made by country managers.

Sperry Rand presents an interesting contrast to the organizational and control structure of IBM and World Trade. Instead of maintaining a separate international division, Sperry Rand has elected to structure the company into internationally oriented product divisions.¹³⁷ "Some of the product divisions have their own international departments; others operate in turn as worldwide corporations."¹³⁸ Thus, the product divisions exercise responsibility over both domestic and foreign operations, facilitating coordinated global strategy.¹³⁹

Despite the degree of decentralization inherent in the product division structure, Sperry Rand is able to maintain channels of communication that "cut across product lines."¹⁴⁰ The "umbrella company," a device that "join[s] all Sperry affiliates in a single country under a single legal framework,"¹⁴¹ is utilized to exercise control at the international level. The umbrella company "channels communications among the product divisions within the country [and] . . . presents a unified corporate image of Sperry Rand to the public."¹⁴² However, actual line responsibility is not exercised by the umbrella company but is transmitted between the product division in the foreign country and the parent product division headquarters in the United States.¹⁴³ Over 100 foreign companies have been associated under the umbrella format.¹⁴⁴ In addition, further control is main-

132. *Id.* at 17.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.* at 27.

138. *Id.*

139. *See id.* at 19 for a list of characteristics of the MNE, many of which are particularly applicable to Sperry Rand.

140. *Id.* at 27.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

tained through regional offices that coordinate "companies of a single product division within a specific region."¹⁴⁵

Thus, two major MNEs have adopted widely differing organizational and control structures in order to manage effectively international operations. Their experiences indicate the range of alternative strategies available to an emerging multinational enterprise.

IV. THE MULTINATIONAL ENTERPRISE FROM A LEGAL PERSPECTIVE

A. *A Legal Definition*

The law relating to international corporate investments remains undeveloped despite the dramatic rise of MNEs since World War II. The lack of a definitive international business law, despite large-scale international economic transactions, has not gone unnoticed.¹⁴⁶ Thus, while the character of business has become multinational, the essence of corporate law remains national. This incongruity creates problems for company management and other interested groups, including the investing public, organized labor, the general public, and regulating nations.

There is no generally accepted legal definition of the MNE. The typical MNE is a cluster of separate legal entities in several jurisdictions, which exist only if the laws of each jurisdiction recognize them as legal entities. The MNE is a business and economic creature, and the usage of that term is presently found only in those fields. The lack of a precise legal definition results in the use of a multiplicity of inconsistent and confusing terms to describe these business operations. Even the use of the term "multinational" is not standard and exclusive. Terms such as "plurinational," "transnational," "international," "supranational," "global," "world," and others are used in this context, often interchangeably. The term "enterprise" does not have a precise legal connotation and is used interchangeably with other more common terms of business organization such as "corporation," "company," "firm," "body corporate," "corporate combine," or "corporate enterprise."

The term "multinational enterprise," convenient as a descriptive business term, is also preferable as a legal term. MNEs are not organized under any kind of international or supranational law; therefore, it is not accurate to call them international or suprana-

145. *Id.*

146. See, e.g., Timberg, *International Combines and National Sovereigns*, 95 U. PA. L. REV. 575 (1947) [hereinafter Timberg].

tional enterprises.¹⁴⁷ MNEs do not derive a legal personality from international law, as, for example, from a treaty or act of an international organization. They are organized under, and governed by, each country's national laws. Nor are MNEs organized under an international uniform corporation law pursuant to a treaty. Hence, these corporations cannot be regarded as international in the sense that contracting states have assumed specific obligations concerning the treatment and privileges applicable to such enterprises.¹⁴⁸ The term "multinational corporation," which is widely used in business literature, is also misleading since an MNE usually consists of several corporations or other forms of business organization. Such a group of related corporations, each with its own legal identity, constitutes a single *economic* entity—the "enterprise."¹⁴⁹ However, properly viewed the MNE is not a single *legal* entity, but rather a group of corporations throughout the world sharing a single underlying economic unity. One commentator thus correctly observed that the MNE may be referred to as a multinational cluster of corporations in several countries, controlled by one headquarters.¹⁵⁰ Accord-

147. There is the exception for intergovernmental joint ventures that may be recognized as "international corporations" because they are created by treaty. See Note, *Corporations Formed Pursuant to Treaty*, 76 HARV. L. REV. 1431 (1963). However, this is not the case with private business enterprises that must organize under national laws. See E. STEIN, *HARMONIZATION OF EUROPEAN COMPANY LAWS* 437-43 (1971) [hereinafter E. STEIN]. Some examples of the international corporation are the Scandinavian Airline System (SAS), Air Africa, the Suez Canal Company, and such international institutions as the Bank for International Settlements, the International Finance Corporation, and the Central American Air Navigation Services Corporation. Another example stems from the Convention Respecting Luxembourg Railways, Between Belgium, France and Luxembourg, April 17, 1946, 27 U.N.T.S. 103, which established a company to operate Luxembourg Railways. For further examples of such international public enterprises and their legal status, see C. FLIGLER, *supra* note 15. Such "international corporations" play a relatively minor role in the new world economy. For a definition of the international corporation, see Goldman, *Les sociétés internationales*, in COURS PROFESSÉ À L'INSTITUT DES HAUTES ETUDES INTERNATIONALE DE PARIS 2 (1961-1962), cited in Schmitthoff, *Multi-National Companies*, 1970 J. BUS. L. 177. See also Kahn, *International Companies*, 3 J. WORLD TRADE L. 498 (1969).

148. See E. STEIN, *supra* note 147, at 437-38.

149. See Berle, *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 344 (1947), for the argument that "where the corporate entity is defective, or otherwise challenged, its existence, extent and consequences may be determined by the actual existence and extent and operations of the underlying enterprise, which by these very qualities acquires an entity of its own, recognized by law." While courts all over the world have focused on the underlying enterprise for various limited purposes, such an entity has not yet been generally recognized by law. For further discussion of the concept of enterprise, see E. LATTY, *SUBSIDIARIES AND AFFILIATED CORPORATIONS* 196 (1936) [hereinafter E. LATTY]; Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12 (1925) [hereinafter Ballantine]; Foley, *Incorporation, Multiple Incorporation and the Conflict of Laws*, 42 HARV. L. REV. 516, 528 (1929). See notes 252-89 *infra* and accompanying text.

150. Aharoni, *On the Definition of the Multinational Corporation*, 11 Q. REV. ECON. & BUS. 27, 35 (1972) (suggesting that such a multinational cluster must involve corporations operating in at least five countries).

ingly, the term "multinational corporation" is properly reserved for reference to the corporation that controls an MNE (or the multinational cluster).¹⁵¹

This Article is concerned with the normal forms of international investment carried on by private firms. Most MNEs consist of several business units in several countries, each one of which is an established legal entity.¹⁵² Thus, the MNE has been defined as "a business organization characterized by (a) business operations in two or more countries, (b) a unified top direction, and (c) legally distinct but economically dependent business units subject to that unified direction."¹⁵³ The various corporations or other legal entities of diverse nationalities are joined together by ties of common control and respond to a common management strategy. It is these ties of control that distinguish the MNE as a business phenomenon from a group of separate firms in different jurisdictions merely engaged in business relations with each other. Of course, the extent to which the international headquarters actually directs the operation of the various national companies depends, as has been noted, on the peculiar management strategies of the individual enterprise.¹⁵⁴

In a typical MNE, the headquarters is a central parent holding company¹⁵⁵ that controls the various foreign subsidiaries either directly or, more commonly, through a foreign holding company. Control is usually assured by ownership of a majority of stock of the controlled firms.¹⁵⁶ The foreign subsidiaries are established by the parent company or formed by acquisition of control of existing companies. MNEs are also formed by combining two or more companies from different countries. After merger or reorganization, the former firms may or may not be dissolved.¹⁵⁷ Whether or not the companies are formally combined to form a new legal entity, the actual economic result is a single, unified enterprise.

151. Such terminology is correct from a legal point of view since it relates to a single corporation, but because it is frequently used inaccurately in business literature, such a controlling corporation will generally be referred to in this Article as the parent corporation, to distinguish it from the MNE as a whole.

152. See Litvak & Maule, *The Multi-national Firm and Conflicting National Interests*, 3 J. WORLD TRADE L. 309, 311 (1969), for a diagram of the various business relationships that can be created by the MNE.

153. Timberg, *supra* note 146, at 577. In fact, the author called the MNE "an international combine." *Id.*

154. See notes 108-24 *supra* and accompanying text.

155. See text accompanying note 165 *infra*.

156. This is typical of MNEs based in the United States. In many cases MNEs insist on having wholly owned or majority owned subsidiaries, although control can be assured, as a practical matter, by ownership of less than a majority of the stock.

157. Cf. INT. REV. CODE OF 1954, § 368(a).

The MNE resulting from economic integration is not necessarily formed by means of stock control. Control can also be obtained by a contract between formerly independent companies in which each firm becomes obligated to adhere to common business strategies. A variety of contract forms are available to accomplish this result.¹⁵⁸ These forms of control are often designed to avoid the legal obstacles to mergers across national boundaries that arise from transfer of a company's headquarters or principal place of business from one country to another.¹⁵⁹

Regardless of which form or legal technique is used to establish the enterprise as a single economic entity, it is the interaction between the transnational control of business groups and national political institutions that generates the most significant legal and political conflicts involving the MNE. The question raised is in what instances, and to what extent, will nation-states recognize the existence of the control ties.¹⁶⁰ In other words, when and for what legal purposes do the regulating countries consider the local business operation as a separate entity, and when do they view it as an integral part of a larger enterprise controlled abroad?

B. *The Form of Business Organization*

The precise form of business organization selected for each unit of the MNE in the various countries of operation depends on a combination of general management planning, the relevant business laws of the host country and the home country, and any international agreements to which the two countries are signatories. The result is that the MNE is comprised of different types of legal entities, which generate more than mere differences in terminology.

1. *The Corporation*

Because of the predominant role played by American-based MNEs, perhaps the most widely used business form is the corporation. Corporations range in size from the gigantic firm owned by several millions of shareholders to the "close" corporation held by one or a few shareholders.¹⁶¹ The existence of the corporate form

158. This is typical of the European-based MNE, such as Unilever, which is a combination of the British Unilever Ltd. and the Dutch Unilever NV. The German Agfa and the Dutch Gevaert were integrated through the use of a holding company. See text accompanying note 75 *supra*. See also notes 370-75 *infra* and accompanying text.

159. See text accompanying notes 172-74 *infra*.

160. See notes 369-94 *infra* and accompanying text for the recognition of control ties by the Konzernrecht, the German Law of Related Companies.

161. Despite the substantial differences between the closely held corporation and

allows an enterprise to organize a series of related corporations through which the business of the firm is conducted. Properly used, the separation of the enterprise into distinct legal entities enables corporations to achieve greater efficiency. It can provide a convenient vehicle through which a single group can manage many different businesses, particularly when it is desirable to distinguish between the manufacturing, marketing-service, and financial divisions of the enterprise. Central business strategies may be formulated, provided the disadvantages of over-centralization are appreciated.¹⁶² The multi-corporate operation of an enterprise may also be a direct result of the parent corporation's expansion through purchase of stock in companies in the same field. Thus, "a corporation, control of which has been acquired by purchase, may be operated as a subsidiary to retain the benefit of its well-advertised corporate name, and good will and separate merchandising policies"¹⁶³

The separation of an enterprise into distinct legal entities also serves to reduce financial risks. Subsidiaries may be used for risky divisions or uncertain business ventures in order to limit liability to the property of the subsidiary corporation, thereby immunizing the parent and its other subsidiaries from those particular risks.¹⁶⁴

The holding corporation is a device created to serve the needs of large business combinations, especially when the individual companies of the enterprise are domiciled in different states or countries.¹⁶⁵ Holding companies may be divided into two basic types. There are financial holding companies "which invest in securities solely for the purpose of dividend or interest income and capital gains, without performing any actual commercial or industrial services for affiliated companies."¹⁶⁶ Then there are industrial or commercial holding companies in which the parent company renders

the publicly held corporation, in many of the fifty American states both are organized under and subject to the same corporation statute. *See, e.g.*, CAL. CORP. CODE §§ 100-6804 (Deering 1962). However, some modern statutes contain provisions specifically governing close corporations. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 341-56 (1968 Cum. Supp.); FLA. STAT. ANN. 608.70-.77 (1972-1973 Supp.). Statutes in several other states contain provisions that, as a practical matter, are relevant only to close corporations. *See, e.g.*, N.C. GEN. STAT. §§ 55-73 (1965). *See* ABA-ALI MODEL BUS. CORP. ACT §§ 15, 16(f), 32, 34-37, 40, 50, 54, 60, 73, 79, 143-45 (1969), for important provisions especially applicable to close corporations.

162. *See* L. GOWER, MODERN COMPANY LAW 195 (3d ed. 1969) [hereinafter L. GOWER].

163. H. BALLANTINE, CORPORATIONS § 168 (rev. ed. 1946) [hereinafter H. BALLANTINE].

164. *Id.*

165. 6A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2821 (Perm. Ed. 1963) [hereinafter W. FLETCHER].

166. INTERNATIONAL CHAMBER OF COMMERCE, INTERNATIONAL GUIDE TO COMPANY FORMATION 37 (no. 263, 1970) [hereinafter ICC 263].

services on a permanent basis and interacts with affiliated companies within the MNE, primarily for purposes of expansion.¹⁶⁷ Due to the advantages of the holding company over a consolidation, purchase, or lease, many holding companies have been formed for the purpose of controlling other companies.¹⁶⁸

Although the holding company developed in the context of the American federal system, the principle is of great utility in the international context. The MNE can use one or more of its companies (usually in the form of an intermediate holding company) as a profit center to facilitate reinvestment of earnings abroad. Expansion of subsidiary operations is particularly encouraged when such earnings enjoy tax deferrals in the home country until actual remittance, so that earnings of foreign subsidiaries are taxed by the home country only if and when they are distributed to the parent company in that country. However, this possibility, as applied to American-based MNEs, is restricted by the Revenue Act of 1962,¹⁶⁹ and similar limitations are currently in effect or contemplated by a few other industrialized countries, notably Canada—where it has been adopted but is not yet effective¹⁷⁰—and Germany—where it has been passed by the Bundestag (Parliament) but is awaiting action by the Bundesrat (Council of State).¹⁷¹ There are, however, differences in the scope of these laws.

The corporate form in general, and the holding company form in particular, can assist the MNE in mitigating the effect of restrictive laws of undeveloped nations and the conflicts in legal requirements among the various sovereignties involved. In a regional market, such

167. *Id.*

168. 6A W. FLETCHER, *supra* note 165, § 2821. The holding company form can be used to integrate numerous operating corporations as a means of facilitating the sale of securities or utilizing service contracts with subsidiaries. Control may be maintained through a pyramid structure with a holding company at the top controlling intermediate holding and operating subsidiaries, which in turn control operating subsidiaries at the base. Such a structure can result in maximum control with minimum investment. H. BALLANTINE, *supra* note 163, § 168. See A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 69-75 (rev. ed. 1968) [hereinafter A. BERLE & G. MEANS] for a discussion of "pyramiding."

The holding company is only one of many structural forms available to control large businesses. The "megasubsidiary," a massive wholly owned subsidiary corporation, has developed only recently, but already occupies an important position in business. See Eisenberg, *Megasubsidiaries: The Effect of Corporate Structure on Corporate Control*, 84 HARV. L. REV. 1577 (1971).

169. INT. REV. CODE OF 1954, §§ 951-64. See text accompanying note 328 *infra*.

170. Income Tax Act of 1970, c. 63, §§ 90-95. See Verchere & Pound, *The New Canadian Tax Law: A Summary of How It Operates*, 37 J. TAX 220, 223 (1972).

171. See [Doing Business in Europe] CCH COMM. MKT. REP. ¶ 30,603 (July 19, 1972); 2 EUROPEAN TAXATION 1/4 (1971); CCH, HARV. WORLD TAX SERIES, TAXATION IN GERMANY ¶ 1814.

as the European Common Market, the holding company is used to accomplish transnational mergers. A direct merger involving the dissolution of the constituent companies across national boundaries is impossible under some laws and, even where possible, generally involves tremendous expenses, primarily in taxes, as the consequence of moving the central administration of a company from one country to another.¹⁷² In reality, such transnational mergers have taken place. In view of the uncertainty regarding the legal consequences of such mergers on the Continent, the current corporate practice is to form a mutual subsidiary company to which the operations of the integrating companies are transferred. The stock of the new subsidiary is divided between the two founders pursuant to their agreement.¹⁷³ The two companies can thus set up new operating companies, dividing the stock between themselves and converting the two parents into holding companies, which are managed by the same directors. The result is the creation of one economic unit instead of two, despite a legal separation.¹⁷⁴

Generally speaking, the MNE may adopt the most beneficial business form for transnational business operations, taking into account the relevant home country laws, host country laws, and international treaties. The example of an American-based MNE can be used to illustrate the adaptability of MNEs to changing circumstances. What business form is appropriate for investment in Latin America? Assume that tax factors are critical and that other considerations are unaffected by the investor's decision. The MNE may: (a) establish an operating subsidiary in the Latin American country, directly or through an intermediate holding company, or (b) set up a branch (permanent establishment) in the Latin American country. For American tax purposes, the operating subsidiary is a separate tax entity.¹⁷⁵ The enterprise may enjoy tax deferral until repatriation of earnings.¹⁷⁶ Repatriation may be accomplished through the intermediate holding company serving as a profit center abroad. The

172. See generally E. STEIN, *supra* note 147, at 364-87; Conard, *Corporate Fusion in the Common Market*, 14 AM. J. COMP. L. 573 (1966). Liquidation involves taxation of the hidden reserves and thus prevents many mergers. See, e.g., Storm, *A New Impulse Toward a European Company*, 26 BUS. LAW. 1443 (1971) [hereinafter Storm].

173. See, e.g., Angelo, *supra* note 2, at 504-05; Mann, *The European Company*, 19 INTL. & COMP. L.Q. 468, 478-79 (1970).

174. The Agfa-Gevaert "merger," between the largest German and Belgium manufacturers of photographic products, is an example in point.

175. See notes 290-300 & 316 *infra* and accompanying text.

176. INT. REV. CODE OF 1954, §§ 951-64.

MNE may also enjoy special tax treatment because of investment in developing countries.¹⁷⁷ In addition, operation through a subsidiary can be desirable from the host country's viewpoint. Frequently the MNE may enjoy the benefits of concessions laws, which encourage investment by providing for national treatment (nondiscriminatory treatment as a domestic investor) only if a separate entity is established in the host country. In other instances, domestic incorporation is obligatory.¹⁷⁸

If the MNE prefers, on the other hand, to launch its foreign investment through a permanent establishment in the Latin American country, the foreign investment will be taxable in the United States as part of MNE operations. This would enable the United States investor to deduct early period anticipated losses from the venture abroad.¹⁷⁹ A third alternative open to an American-based MNE investing in Latin America is to establish another United States corporation, complying with the Western Hemisphere trade corporation provisions that grant a special tax deduction to qualifying corporations.¹⁸⁰ Also available to an American-based MNE for investment abroad is the new Domestic International Sales Corporation (DISC).¹⁸¹ By utilizing this corporate instrumentality, the domestic corporation that engages primarily in export sales and meets certain other requirements qualifies for a fifty per cent tax deferral of earnings abroad. Thus, an enterprise may choose among many alternatives, each with its own peculiar advantages, when considering foreign investment.

177. The main advantages result from the foreign tax credit provision, which, after the Revenue Act of 1962, resulted in special treatment for foreign corporations in less developed countries. INT. REV. CODE OF 1954, § 902. Section 1248(d)(3) provides an exemption for the gains from a sale or exchange of stock owned by a foreign corporation in a lesser developed country. Sections 951-64 (particularly sections 954(b)(1), 955(b)(1), & 955(c)) provide certain exceptions from the 1962 abolition of the tax deferral for Subpart F income for foreign companies in lesser developed countries. See generally Hellawell, *United States Income Taxation and Less Developed Countries: A Critical Appraisal*, 66 COLUM. L. REV. 1393 (1966).

178. See THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS, REPORT 87 (1955) [hereinafter ANTITRUST LAWS].

179. This is a very important factor in high-risk operations or when losses are anticipated for the first years of the investment. However, a tax treaty between the countries involved can alter the applicable rules. See Hadari, *Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise*, 20 AM. J. COMP. L. 111 (1972) [hereinafter Hadari].

180. INT. REV. CODE OF 1954, §§ 921-22.

181. See INT. REV. CODE OF 1954, §§ 991-97 for a definition of DISC and related terms. See also B. BITTKER & J. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* § 17.14 (Supp. 1972) [hereinafter B. BITTKER & J. EUSTICE].

2. *European Business Forms*

The business entities forming an MNE represent not only differences between countries, but also between available alternatives within a given country. In Britain, for example, the most important form of business is the company limited by shares, which may be a "public" or a "private" company. The major differences between these forms lie in restrictions on the number of shareholders and the transferability of shares. Private companies must have at least two, but no more than fifty, shareholders (although exceptions are made for current and former employees), must impose restrictions on the transferability of shares, and are prohibited from offering their shares to the public.¹⁸² A public company must have at least seven shareholders¹⁸³ and does not have restrictions on either the maximum number of shareholders or on the transferability of shares.¹⁸⁴ The private company is much more prevalent than the public company, and may command substantial resources and employ large numbers of employees; thus, the private company is a potential business form for an MNE's subsidiary in Britain. Most of the provisions of the British Companies Act apply equally to private and public companies. These two business forms appear in the many countries that follow the British system such as Israel,¹⁸⁵ Australia,¹⁸⁶ and South Africa.¹⁸⁷

On the Continent there is a different statutory framework.¹⁸⁸

182. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 1, 28.

183. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 1.

184. The British public companies should not be confused with government-owned corporations or with publicly held corporations (or "quoted" companies). See L. GOWER, *supra* note 162, at 234-41. Public companies can be privately owned and not listed on the Stock Exchange.

185. Israeli Companies Ordinance of 1929, *as amended*, § 25A. The Ordinance was based on the English Companies Act of 1929, 19 & 20 Geo. 5, c. 23.

186. Australian Uniform Companies Act, §§ 5, 15, which has been adopted by the separate Australian states. See, e.g., Companies Act of 1961 of New South Wales, §§ 5, 15. The Australian facsimile of the British private company is known as a "proprietary company."

187. Companies Act, No. 46 of 1926, § 104.

188. The literature on the various types of European business organizations includes THE COMPANY—LAW, STRUCTURE AND REFORM IN ELEVEN COUNTRIES (C. de Houghton ed. 1970) [hereinafter C. de Houghton]; R. PENNINGTON, COMPANIES IN THE COMMON MARKET (2d ed. 1970); E. STEIN, *supra* note 147, at 87-117; Bott & Rosener, *The Groupement d'Intérêt Economique*, J. BUS. L., Oct. 1970, at 313; DeVries & Juenger, *Limited Liability Contract: The GmbH*, 64 COLUM. L. REV. 866 (1964); Fabricius, *The Private Company in German Law*, J. BUS. L., July 1970, at 229; Kohler, *New Corporation Laws in Germany (1966) and France (1967) and the Trend Towards a Uniform Corporation Law for the Common Market*, 45 TUL. L. REV. 58 (1968); Kohler, *The New Limited Liability Company Law of France*, 24 BUS. LAW. 435 (1969); Scholten, *Company Law in Europe*, 4 COMM. MKT. L. REV. 377 (1968); Steefel & Falkenhausen, *The New German*

There are continental equivalents of the stock corporation.¹⁸⁹ However, there is also the limited liability company, in which ownership is not normally evidenced by share certificates but rather by quotas with transferability limitations.¹⁹⁰ This hybrid business form between a stock company and a partnership is without parallel in Anglo-American law.¹⁹¹ The limited liability company is subject to more flexible statutory requirements than stock companies, and this type of company is frequently found when there are only a small number of owners with no intention of going public.

These and other forms of doing business are subject to different legal requirements according to the law of the country of incorporation. The management of the MNE must consider many variables including the requisite necessary capacity to form the business unit;¹⁹² the required minimum or maximum number of shareholders; the capital structure; the form of shares (registered or bearer); voting rights; the rights and liabilities of shareholders, creditors, employees, and officers; the eligibility of directors;¹⁹³ and the various provisions relating to control of the day-to-day operation of the firm.

Of more enduring concern to the MNE may be the differences in the rules of management and control of the company. Different legal requirements in various countries may interfere with the efficient management of the MNE, causing artificial fragmentation of the enterprise and additional operating costs. One example is provided by German law. A German subsidiary of an American-based MNE

Stock Corporation Law, 52 CORNELL L. REV. 518 (1967) [hereinafter Steefel & Falkenhäusen]; Vagts, *Reforming the "Modern" Corporation: Perspectives from the German*, 80 HARV. L. REV. 23 (1966) [hereinafter *Perspectives*]; Wooldridge, *The Private Company in French Law*, J. BUS. L., Oct. 1970, at 317.

189. They are the "société anonyme" (S.A.) in France, Belgium, Luxemburg, and Switzerland; "aktiengesellschaft" (A.G.) in Germany, Austria, and Switzerland; and the "società per azioni" (S.p.A.) in Italy. ICC 263, *supra* note 166, at 8. In addition there is the "naamloze vennootschap" (N.V.) in the Netherlands.

190. *Id.* The limited liability company is known as "Société à responsabilité limitée" (S.à.r.l.) in France; "Société de personnes à responsabilité limitée" (S.P.R.L.) in Belgium; "Gesellschaft mit beschränkter Haftung" (G.m.b.H.) in Germany; "Sociedad a responsabilidad limitada" (L.T.D.A.) in the Latin American countries; and "besloten vennootschap met beperkte aansprakelijkheid" (B.V.) in the Netherlands.

191. *Id.*

192. For instance, in Belgium only two or more natural persons (not corporations) may form an S.P.R.L., DROIT CIVIL ET COMMERCIAL bk. 1, tit. IX, § 119. (Codes Larcier 1970).

193. Although under most enabling corporation laws there are no restrictions concerning the nationality or residence of directors, some do have restrictions. In Switzerland, for instance, except in holding companies, the majority of directors must be of Swiss nationality and domicile. CODE FÉDÉRAL DES OBLIGATIONS § 711 (Payot 1962).

has a different structure of power and control than its American parent corporation. While under prevailing corporation laws in the United States the corporation is managed by a single board of directors that is appointed by and responsible to the shareholders, a German company is managed according to a two-tier system consisting of a board of management and a supervisory board.¹⁹⁴ The supervisory board oversees the board of management and reports to the shareholders.¹⁹⁵ It appoints or removes the members of the board of management,¹⁹⁶ but does not interfere with the day-to-day conduct of business, which is in the hands of the board of management.¹⁹⁷ The supervisory board members, except for labor representatives, are elected by the shareholders in a straight-line voting system.¹⁹⁸ The German two-tier system, with modifications, has been introduced in France under its law on Commercial Companies of 1966.¹⁹⁹

A variant of Germany's two-tiered management system was enacted in the Netherlands in 1971. A supervisory board may be established by all Dutch companies,²⁰⁰ but must be established by "large" companies.²⁰¹ A company is a "large company" if it has capital, including reserves, of at least ten million guilders, it or its subsidiaries have an "employee's council," and the company and its subsidiaries normally employ one hundred persons or more in the Netherlands.²⁰² The supervisory board in large companies nominates and removes the members of the board of management (*directeuren*),²⁰³ adopts the financial statements,²⁰⁴ and approves important specified decisions of the board of management.²⁰⁵ The members

194. *AKTIENGESETZ* 1965 (AKTG) §§ 76-116 (the German Stock Corporation Act of 1965). See CCH COMM. MKT. REPORTS (transl. F. Juenger & L. Schmidt 1967) for an unofficial bilingual translation. For a discussion of the two-tier system in Europe, see C. de Houghton, *supra* note 188, at 140-63; E. STEIN, *supra* note 147, at 91-155; *Perspectives*, *supra* note 188, at 50.

195. AKTG § 111 (1965).

196. AKTG § 84 (1965).

197. AKTG § 111(4) (1965).

198. AKTG § 101 (1965).

199. C. COM., app. 8, pt. 2, §§ 118-50 (*Petits Codes Dalloz* 1967).

200. *WETBOEK VAN KOOPHANDEL* (W.v.K.) § 50 (the Netherlands Business Corporation Code). See CCH COMM. MKT. REPORTS No. 193 (transl. Morris, J. van de Ven & Westbroek 1972) for an unofficial English translation. See also van de Ven, *Corporate Developments in the Netherlands*, 27 BUS. LAW. 873 (1972) [hereinafter van de Ven].

201. W.v.K. § 52h.

202. W.v.K. § 52c(2).

203. W.v.K. § 52l.

204. W.v.K. § 52m.

205. The following actions are subject to supervisory board approval: issuance of shares and debentures by the company, listing shares on a stock exchange, collaboration with other firms, acquisition of a large portion of the stock of other companies, and termination of employment of a considerable number of employees. W.v.K. § 52n.

of the supervisory board are normally elected by the board itself.²⁰⁶ A large corporation that belongs to an MNE may be exempted, however, from some of the foregoing rules if it is a subsidiary of another company and most of the employees of the whole enterprise are employed outside the Netherlands, or if it is a company that almost exclusively renders management and financial services to such a subsidiary.²⁰⁷ Additional exceptions are provided for Dutch affiliates of foreign companies.²⁰⁸ Other EEC members will have to amend their company laws to provide for dual management, should the Commission's fifth directive on harmonization of company law be adopted.²⁰⁹

Another feature of the German law that has an impact on MNE operations in that country is the concept of "codetermination" under which a company's employees participate in management.²¹⁰ Two types of codetermination presently exist in Germany: full codetermination in companies with over 1,000 employees in the coal and steel industries;²¹¹ and partial codetermination in all limited liability companies (G.m.b.H.) with over 500 employees and in all stock companies (A.G.) except family-owned companies with fewer than 500 employees.²¹² Full codetermination entitles the representatives of the workers and the shareholders to an equal number of seats on the supervisory board.²¹³ In addition, a neutral balancing member is chosen to represent the public interest.²¹⁴ In partial codetermination, one third of the supervisory board is appointed by the employees²¹⁵ and there is no labor member on the board of management.²¹⁶

Finally, the relationship between the employees and the com-

206. W.v.K. § 52h.

207. W.v.K. § 52c(3).

208. [Doing Business in Europe] CCH COMM. MKT. REP. ¶¶ 26,711, 26,721 (1972).

209. ECC Commission, Proposal for a Fifth Directive, Oct. 19, 1972, 15 E.E.C. J.O. C131/149 (1972) [hereinafter Fifth Directive]. See *Fifth Directive on Company Law Harmonization Proposed*, [New Developments] 2 CCH COMM. MKT. REP. ¶ 9532 (1972). The Fifth Directive is proposed pursuant to the Treaty Establishing the European Economic Community, March 25, 1957, art. 54(3)(g), 298 U.N.T.S. 39.

210. See generally C. de Houghton, *supra* note 188, at 213-21; E. STEIN, *supra* note 147, at 92-97; Steefel & Falkenhausen, *supra* note 188, at 537; *Perspectives*, *supra* note 188, at 65.

211. Law on Codetermination of Employees in Supervisory Councils and Executive Boards of Coal, Iron & Steel Producing Industries of May 21, 1951, § 4, [1951] BGBI. I 347, 348 (Mitbestimmung) [hereinafter Law of May 21, 1951].

212. Law on Works Council of Oct. 11, 1952, § 76(i), [1952] BGBI I 681, 691 (Betriebsverfassungsgesetz) [hereinafter Law of Oct. 11, 1952].

213. Law of May 21, 1951, § 4, [1951] BGBI. I 348, 349.

214. Law of May 21, 1951, § 8, [1951] BGBI. I 348.

215. Law of Oct. 11, 1952, § 76(i), [1952] BGBI. I 691.

216. Law of Oct. 11, 1952, § 76, [1952] BGBI. I 691.

pany's management is governed by the new Works Council Act.²¹⁷ The Act provides for the management, duties, and rights of the Works Council elected by the employees. The Works Council is entitled to discuss and negotiate labor disputes with management,²¹⁸ and if no agreement is reached, a conciliation board established by both parties will decide the dispute.²¹⁹ The Works Council has the right to be informed and consulted on various labor matters.²²⁰ Significantly, the Works Council is entitled to codetermination on many important economic, business, and social decisions that affect the welfare of the employees.²²¹ The right of employees to be informed and consulted by management is broad enough to include such matters as structural changes and mergers of the enterprise,²²² as well as various general economic subjects.²²³

Other European countries also provide for employee representation in the managerial process. In France, although employees of an S.A. are not entitled to appoint members of either board, a company employing over fifty persons must establish a Works Council (*comité d'entreprise*), members of which are employees.²²⁴ Since 1968, a compulsory employees' profit-sharing program has been in effect.²²⁵

In the Netherlands, under recently enacted legislation, a Dutch company or a local branch of a foreign company, which employs a hundred persons or more, is required to establish an Employees Council,²²⁶ elected by the employees. The company's director (*bestuurder*) is also a member of the Council.²²⁷ The Council must be informed of the financial position of the company and its general business activities, and normally has advisory powers in certain im-

217. Law on Works Council of Jan. 15, 1972 (*Betriebsverfassungsgesetz*) [hereinafter *Law of Jan. 15, 1972*]. See CCH COMM. MKT. REPORTS (transl. H. Beinhauer 1972) for an unofficial English translation.

218. Law of Jan. 15, 1972, § 74.

219. Law of Jan. 15, 1972, § 76.

220. Law of Jan. 15, 1972, § 90.

221. Law of Jan. 15, 1972, §§ 87, 91, 99, 102.

222. Law of Jan. 15, 1972, §§ 111-13.

223. Law of Jan. 15, 1972, §§ 106-10. The Act provides for the establishment of an Economic Committee by the Works Council in enterprises with more than 100 permanent employees.

224. Ordinance of Feb. 22, 1945, C. Com. app. 2, pt. 2, at 514 (*Petits Codes Dalloz* 1971).

225. Ordinance No. 37-693 of Aug. 17, 1967, C. Com. app. 2, pt. 2, at 527 (*Petits Codes Dalloz* 1971), supplemented by Decree No. 67-1112 of Dec. 19, 1967, C. Com. app. 2, pt. 2, at 532 (*Petits Codes Dalloz* 1967).

226. Wet op de Ondernemingsraden, art. 2.1 (*Employees Council Act of 1971*).

227. Wet op de Ondernemingsraden, art. 6.1.

portant corporate matters specified in the law.²²⁸ The Council's advice is particularly important in certain matters relating to the employees such as wages, training courses, hiring, promoting, and firing of employees, and is absolutely required in other labor matters, including pension and profit-sharing plans, which are void absent the Council's advice.²²⁹ The Council may recommend members to the supervisory board in large companies²³⁰ and object to appointments to the supervisory board.²³¹ Such an objection may be overruled by the Dutch Social Economic Council (Sociaal Economische Raad).²³² The codetermination system is now proposed for all EEC members.²³³

V. THE LEGAL STRUCTURE OF THE MULTINATIONAL ENTERPRISE

A. *The Modern Enterprise*

The forces which have generated these multinational corporate groups are not simple

One has been the emergence of the corporate form itself, endowed with attributes that give it extraordinary advantages as a vehicle for doing business. The corporation can count on perpetual life; it can hope to attain unlimited size; it can bear children or create parents or generate siblings; and it can endow each of its newborn relations with such nationality as seems convenient.²³⁴

MNEs are integrated on a global basis, a characteristic not enjoyed by political institutions.²³⁵ Since effective regulation of the affairs of a national government is largely confined to activities within its borders, any extraterritorial objective "involves either a conflict, a negotiation, or a concordat with other sovereign powers."²³⁶ By contrast, the upper management of an MNE can effectuate its

228. Wet op de Ondernemingsraden, art. 25.1. See van de Ven, *supra* note 200, at 875. The company is exempted from giving such information and from the Council's advice if significant interests of the company would be endangered.

229. Wet op de Ondernemingsraden, art. 27.1. See van de Ven, *supra* note 200, at 875.

230. W.v.K. § 52h(4).

231. W.v.K. § 52h(6).

232. W.v.K. § 52h(9), (10).

233. Fifth Directive, *supra* note 209.

234. Vernon, *supra* note 86, at 157. The sharp increase in the efficiency of transportation and communication was also mentioned as a significant force contributing to the emergence of the MNE.

235. See Timberg, *The Corporation as a Technique of International Administration*, 19 U. CHI. L. REV. 739, 741 (1952). The author favored using the corporate concept to accomplish the integration of the international political community.

236. *Id.*

worldwide strategy provided only that a nation does not forbid foreign investment and that the MNE honors domestic laws.²³⁷

Modern corporations now exercise powers once available only to natural persons. Thus, most contemporary legal systems have recognized the corporation as a legal entity separate from the individuals who own it.²³⁸ One of the primary functions of the corporate form is the insulation of individual stockholders from liability for corporate debts. Additional advantages and attributes include separation of management and control from ownership, easy transferability of ownership, ability to retain earnings for internal growth, large investments in research and development, and attraction of large sums of funds either through equity participation or debentures. These factors and the ever increasing sophistication of managerial skills and techniques have brought the corporation to its present status as the principal mode of business organization. Thus, large publicly held corporations now control the economies of most countries.²³⁹

B. *A Corporation's Power To Incorporate
and Own Other Corporations*

The legal prerequisite that is fundamental to the establishment of an MNE is the power of a corporation to purchase and hold stock of another corporation. This power is recognized by most legal systems. In the United Kingdom, for example, a company has this power unless expressly prohibited.²⁴⁰ Similarly, in Canada the power is provided by the Dominion Companies Act.²⁴¹ In the United States, at common law a corporation had no power either to subscribe for, or purchase, stock in another corporation absent an express provision either in its charter or by statute, although exceptions were recognized if the stock purchase was a necessary or reasonable means of achieving a corporation's objectives.²⁴² Corporate acquisition and retention of stock was occasionally found to be contrary to public policy.²⁴³ Even when express power to invest in other corporations was authorized, it was not interpreted to include the power to sub-

237. Cf. *id.*

238. See generally 1 W. FLETCHER, *supra* note 165, §§ 5-14 for the typical attributes of a corporation.

239. See A. BERLE & G. MEANS, *supra* note 168, at 119-40, for a discussion of the evolution of the modern corporation.

240. 6A W. FLETCHER, *supra* note 165, § 2824. Cf. L. GOWER, *supra* note 162, at 194-95.

241. CAN. REV. STAT. § 16(1)(c).

242. *De La Vergne Refrigerating Mach. Co. v. German Sav. Inst.*, 175 U.S. 40 (1899); *California Bank v. Kennedy*, 167 U.S. 362 (1897); *First Natl. Bank v. National Exch. Bank*, 92 U.S. 122 (1875).

243. See, e.g., *State ex rel. Boynton v. Wheat Farming Co.*, 153 Kan. 282, 110 P.2d 795 (1941); *Robotham v. Prudential Ins. Co. of America*, 64 N.J. Eq. 673, 53 A. 842 (1903).

scribe for stock in the formation of another company.²⁴⁴ Presently, however, the power of a corporation to acquire another's stock is granted by the corporation laws of most states;²⁴⁵ but, if under state law a domestic corporation is not allowed to own stock in particular instances, the prohibition applies to ownership of stock in a foreign corporation as well.²⁴⁶

Many corporation laws require more than one incorporator to establish a corporation, and further provide that incorporators must be natural persons.²⁴⁷ These requirements, however, do not prevent the use of "dummy" incorporators to establish subsidiaries and holding companies of the controlling parent.²⁴⁸ A parent company can use persons who have no real interest in the corporation to act as incorporators in order to comply with statutory formalities; usually, after incorporation the dummies' shares are then transferred to the real party in interest—the controlling corporation.²⁴⁹ Reflecting the prevailing realities, the Model Business Corporation Act was revised in 1962 to allow incorporation by one person, including a corporation.²⁵⁰

Corporation statutes frequently require additional formalities relevant to the establishment of an MNE. Some require that a corporation have more than one shareholder, as, for example, in England where a private company must have at least two shareholders.²⁵¹ The use of such requirements, however, has not precluded the use of dummies to assure full *de facto* ownership by the parent corporation.

C. Recognition of the Wholly Owned Subsidiary as a Distinct Entity

1. The General Rule and the Enterprise Theory

Another legal prerequisite to the establishment and successful operation of the wholly owned subsidiary is the recognition of the

244. 6A W. FLETCHER, *supra* note 165, § 2829. Even a grant of such power in the articles of incorporation or in bylaws has not been sufficient in some cases, *id.* §§ 2830-32.

245. *Id.* § 2833 (including citations to the various statutes). However, there are still state constitutional or statutory limitations on such power, restrictions that are in fact merely declaratory of the common law. Usually such restrictions are confined to corporations of a particular kind, *id.* § 2834. See ABA-ALI MODEL BUS. CORP. ACT § 4(g) (1969).

246. 6A W. FLETCHER, *supra* note 165, § 2835.

247. See, e.g., UTAH CODE ANN. § 16-10-48 (1953).

248. H. HENN, LAW OF CORPORATIONS § 185 (2d ed. 1970) [hereinafter H. HENN].

249. *Id.*

250. ABA-ALI MODEL BUS. CORP. ACT § 53 (1969). The current trend among the states is to follow the Model Act and permit a single incorporator. H. HENN, *supra* note 248, § 131.

251. See note 182 *supra* and accompanying text.

separate legal existence of "one-man" corporations. The leading English case, *Salomon v. Salomon & Co.*,²⁵²

opened new vistas to company lawyers and the world of commerce It finally establish[ed] the legality of the one-man company and showed that incorporation was as readily available to the small private partnership and sole trader as to the large public company²⁵³

One-man corporations are also recognized by American law,²⁵⁴ and large corporations make extensive use of them in the creation of subsidiaries and holding companies.

In civil law countries, the issue was not resolved quite so easily. Originally, civil law provided that a corporation was created by a contract among stockholders, rather than by a charter granted by the state.²⁵⁵ Under civil law, therefore, the one-man corporation was "an anomaly—a one-man contract."²⁵⁶ Today, many civil law countries permit wholly owned subsidiaries, although in some countries it remains uncertain whether the parent company may be held responsible for the debts of its subsidiaries.²⁵⁷ Such financial responsibility is also possible, in certain circumstances, under the new German Law of Related Companies.²⁵⁸

Generally, however, the parent corporation, its subsidiaries, and all of the related holding and affiliated companies are recognized and treated as separate and distinct legal entities. This is true even if the parent owns all the stock of the subsidiary, and the management of the corporations is identical.²⁵⁹ Absent illegitimate purpose, the

252. [1897] A.C. 22.

253. L. GOWER, *supra* note 162, at 70. In addition, it was possible for "a trader not merely to limit his liability to the money he put into the enterprise but even to avoid any serious risk to the major part of that." *Id.*

254. H. BALLANTINE, *supra* note 163, § 128; G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 751 (1959, 1968 Supp.) [hereinafter G. HORNSTEIN].

255. See E. STEIN, *supra* note 147, at 327-28 & n.37, 419; Alyea, *Subsidiary Corporations Under the Civil Law and Common Law*, 66 HARV. L. REV. 1227, 1229-34 (1953) [hereinafter Alyea].

256. Vagts, *supra* note 2, at 742 n.13 (1970).

257. See Alyea, *supra* note 255, at 1232.

258. See text accompanying notes 377-79 *infra*.

259. See, e.g., *Fisser v. International Bank*, 282 F.2d 231 (2d Cir. 1960); *Brown v. Margrande Compania Naviera*, 281 F. Supp. 1004 (E.D. Va. 1968); *Garrett v. Southern Ry.*, 173 F. Supp. 915 (E.D. Tenn. 1959), *affd.*, 278 F.2d 424 (6th Cir. 1960); *Berkey v. Third Ave. Ry.*, 244 N.Y. 84, 155 N.E. 58 (1926); *Botwinick v. Credit Exch., Inc.*, 419 Pa. 65, 213 A.2d 349 (1965).

In England, although the theory of agency was applied to lift the veil of a subsidiary company, *Smith, Stone & Knight Ltd. v. Birmingham Corp.*, [1939] 4 All E.R. 116 (K.B.), it is still an exception to the general rule. See *Ebbw Vale U.D.C. v. South Wales Traffic Area Licensing Auth.*, [1951] 2 K.B. 366 (C.A.). See generally Pickering, *The Company as a Separate Legal Entity*, 31 MOD. L. REV. 481 (1968).

separate corporate identities will generally be recognized. However, the corporate veil will be pierced when "the corporate device has been used to defraud creditors, to evade existing obligations, to circumvent a statute, to achieve or perpetuate a monopoly, or to protect knavery or crime" ²⁶⁰

Courts have gone further, in exceptional cases, to ignore the separate existence of corporations in order to treat affected parties "equitably." In the context of a multiple corporations case, the Supreme Court explicitly recognized:

It is not, properly speaking, a rule, but a convenient way of designating the application, in particular circumstances of the broader equitable principle that the doctrine of corporate entity, recognized generally and for most purposes, will not be regarded when so to do would work fraud or injustice. ²⁶¹

Courts have not clearly articulated the theory under which the corporate form may be disregarded for the purposes of preventing fraud or injustice. One commentator has attempted to classify decisions by the courts, which use a variety of terms and purport to apply many different theories, into five theories: ²⁶² the alter ego theory, the identity theory, the instrumentality theory, the agency

260. Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 HARV. L. REV. 1373, 1401 (1938). For evasion of statute cases, see, e.g., *Chicago, M. & St. P. Ry. v. Minneapolis Civic & Commerce Assn.*, 247 U.S. 490 (1918); *Northern Sec. Co. v. United States*, 193 U.S. 197 (1904) (attempt to evade antitrust laws through holding company). For evasion of contract cases, see, e.g., *Dairy Co-operative Assn. v. Brandes Creamery*, 147 Ore. 488, 30 P.2d 338 (1934). For disregard of a subsidiary corporation when it is used to defraud creditors, see, e.g., *Eisenrod v. Utley*, 211 F.2d 678 (9th Cir. 1954).

The English courts have occasionally pierced the corporate veil, finding British subsidiaries to be the agents of the American parent corporation. *In re F.G. (Films) Ltd.*, [1953] 1 W.L.R. 483 (Ch.) (emphasizing thin capitalization); *Firestone Tyre & Rubber Co. v. Llewellyn*, [1957] 1 W.L.R. 464 (H.L.) (agent for tax purposes). See also *In re Greater London Properties Ltd. Lease*, [1959] 1 W.L.R. 503 (Ch.); *Scottish Co-operative Wholesale Soc., Ltd. v. Meyer*, [1959] A.C. 324 (H.L., Sc.); *Holdsworth & Co. v. Caddies*, [1955] 1 W.L.R. 352 (H.L., Sc.); *Spittle v. Thames Grit & Aggregate*, [1937] 4 All E.R. 101 (K.B.).

The case law on the Continent does not vary significantly from its common law counterpart. Continental systems also developed the doctrine of lifting the corporate veil in exceptional circumstances. The implementation of the doctrine varies from country to country, thus no general rule can be stated. In the continental countries the theory has not yet achieved the status it enjoys in the United States. See Cohn & Simitis, "Lifting the Veil" in *the Company Laws of the European Continent*, 12 INTL. & COMP. L.Q. 189 (1963). However, Germany achieved far-reaching results along the lines of the enterprise theory in the provisions regulating the Konzern, AKTG 1965. See notes 369-86 *infra* and accompanying text.

261. *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307, 322 (1939) (the "Deep Rock" case).

262. Annot., 38 A.L.R.3d 1102, 1116-21 (1971) (liability of a corporation for the contracts of its subsidiary). See also Hamilton, *The Corporate Entity*, 49 TEXAS L. REV. 979 (1971).

theory, and the estoppel theory. However, since courts have generally recognized little more than a semantic distinction between the first three theories, the sounder view is to distinguish between disregarding the corporate entity on the one hand, and applying general legal concepts to this area, such as agency or estoppel, on the other. Thus, some cases that speak of disregarding the corporate entity are more properly understood as applications of general agency theories, as, for example, when the acts of a controlled corporation are attributed to the controlling corporation for the purpose of imposing liability because the former is found to be the agent of the latter. This most often occurs in the context of a contractual claim when it is demonstrated that the controlled corporation entered into a contract on behalf of the controlling corporation, or when a tort is attributable directly to the controlling corporation under the doctrine of respondeat superior.²⁶³ In these agency cases, it is the controlled corporation that does the act in question; in the other line of cases the broader *enterprise* does the act; the courts look through the corporate form of the controlled corporation in order to reach the underlying economic reality of a single business undertaking. This distinction is not always observed by the courts, which often speak in terms of disregarding the corporate entity while nevertheless purporting to apply agency concepts.²⁶⁴

In those cases actually disregarding the corporate entity, the recurring theme is that courts will focus on the whole enterprise as a single economic unit, rather than on the multiple-corporate forms used by such an enterprise. Therefore, this general theory is more properly termed the "enterprise" theory.²⁶⁵ This theory, properly construed, encompasses at least three theories that have heretofore been regarded as separate and distinct by the courts. First, the enterprise theory may be invoked to disregard dummy corporations or sham transactions involving fraud or lacking any business substance.²⁶⁶ Second, in applying the enterprise theory, courts have occasionally focused on the fact that the controlled corporation is so closely identified with its parent corporation as to make effectively

263. See, e.g., *Chicago, M. & St. P. Ry. v. Minneapolis Civic & Commerce Assn.*, 247 U.S. 490, 501 (1918); *Fiszez v. Intl. Bank*, 282 F.2d 231 (2d Cir. 1960); *Wyoming Constr. Co. v. Western Cas. & Sur. Co.*, 275 F.2d 97 (10th Cir.), *cert. denied*, 362 U.S. 976 (1960).

264. See Ballantine, *supra* note 149, at 18. See Lowendahl v. Baltimore & O.R.R., 247 App. Div. 144, 155-56, 287 N.Y.S. 62, 74, *affd.*, 272 N.Y. 360, 6 N.E.2d 56 (1936).

265. See note 149 *supra* and accompanying text.

266. See text accompanying notes 291-95 *infra* for the application of the sham theory for tax purposes.

the two corporations one "identity" of enterprise.²⁶⁷ "In the 'identity' theory the separate corporate entity of the subsidiary is disregarded and the parent and the subsidiaries are regarded as one."²⁶⁸ Third, in other circumstances the enterprise theory has been applied when a corporation is under the control of another corporation and has acted as its instrumentality in general or in a particular transaction. Some courts have used this factor to formulate an "instrumentality" rule.²⁶⁹ A frequently cited decision summarized the conditions that justify the invocation of this rule:

Restating the instrumentality rule, we may say that in any case except express agency, estoppel, or direct tort, three elements must be proved:

(1) Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and

(2) Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and

(3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.²⁷⁰

It should be emphasized that under the enterprise theory the controlling company is held responsible for the acts in question because it is the real actor in the transaction and its management had the decision-making power with respect to the particular activity performed. Under such circumstances, any given act of the controlled company may be imputed to the controlling company since, conceptually, the controlled company is but a part of the larger enterprise. But, all other activities, when the subsidiary has acted independently, may not normally be imputed to the parent. Under the enterprise theory, the controlled company is in fact "a fragment of the larger corporate combine which actually conducts the busi-

267. See, e.g., *Zaist v. Olson*, 154 Conn. 563, 227 A.2d 552 (1967); *State ex rel. Monarch Fire Ins. Co. v. Holmes*, 113 Mont. 303, 308, 124 P.2d 994, 996 (1942). This is a situation where for all practical purposes the two corporations are one economic unit, the independence of the controlled corporation did not in effect exist, and an adherence to the fiction of separate entity would serve only to defeat justice by allowing the economic entity to escape liability.

268. *Lowendahl v. Baltimore & O.R.R.*, 247 App. Div. at 156, 287 N.Y.S. at 75.

269. See *Fish v. East*, 114 F.2d 177, 191 (10th Cir. 1940), for a list of the circumstances relevant to the application of the instrumentality rule.

270. *Lowendahl v. Baltimore & O.R.R.*, 247 App. Div. at 157, 287 N.Y.S. at 76.

ness."²⁷¹ Therefore, such subsidiary or affiliate is not necessarily a sham, a dummy for, or identical in all respects to, its controlling company. Under such an approach, for example, a tax haven company, which has no real substance, and a big operating subsidiary of an MNE may both be disregarded with respect to certain activities that in effect are controlled by the parent and therefore are regarded as acts of the enterprise as a whole. Such an enterprise might be the entire MNE or any group of companies of which the controlled company is but a fragment.

While it is premature to announce the death of the distinct entity concept in the context of affiliated companies, recent developments have made it difficult to define with precision the "exceptional cases" in which a subsidiary will now be treated as an agent or fragment of its parent.²⁷² Whether a corporation is an agent or fragment of its parent is a question of both fact and policy that cannot be answered *in vacuo*.²⁷³ It is thus difficult to generalize a rule emerging from the many cases struggling with differing instances of intercorporate relations. The following guidelines have been suggested to assure recognition of separate legal entities:

- (1) A separate financial unit should be set up and maintained . . . to carry on the normal strains [of the business].
- (2) The financial and business records of the two units should be kept separate.

271. *Walkovsky v. Carlton*, 18 N.Y.2d 414, 418, 223 N.E.2d 6, 8, 276 N.Y.S.2d 585, 588 (1966). The enterprise theory has been expressly recognized by the Supreme Court in the labor field:

The [National Labor Relations] Board is entitled to show that these separate corporations are not what they appear to be, that in truth they are but divisions or departments of a "single enterprise" [T]here is a question whether in fact the economic enterprise is one, the corporation form being largely paper arrangements that do not reflect the business realities. One company may in fact be operated as a division of another; one may be only a shell, inadequately financed; the affairs of the group may be so intermingled that no distinct corporate lines are maintained. These are some, though by no means all, of the relevant considerations, as the authorities recognize The petition should be reinstated insofar as it charges the existence of "a single enterprise"

NLRB v. Deena Artware, Inc. 361 U.S. 398, 402-04 (1960). The *Deena* rationale has been followed in *P.F. Collier & Sons Corp. v. FTC*, 427 F.2d 261, 266-70 (6th Cir.), *cert. denied*, 400 U.S. 824 (1970); *ACME Precision Prods., Inc. v. American Alloys Corp.*, 422 F.2d 1395, 1398 (8th Cir. 1970); *NLRB v. Winn-Dixie Stores, Inc.*, 341 F.2d 750, 752 (6th Cir.), *cert. denied*, 382 U.S. 830 (1965).

272. See 1 W. FLETCHER, *supra* note 165, § 43; 2 G. HORNSTEIN, *supra* note 254, §§ 751-59; N. LATTIN, *THE LAW OF CORPORATIONS* §§ 24-26 (2d ed. 1971) [hereinafter N. LATTIN]; Note, *Liability of a Corporation for Acts of a Subsidiary or Affiliate*, 71 HARV. L. REV. 1122 (1958).

273. *National Bond Fin. Co. v. General Motors Corp.*, 341 F.2d 1022 (8th Cir. 1965); *Bowater S.S. Co. v. Patterson*, 303 F.2d 369 (2d Cir. 1962). See N. LATTIN, *supra* note 272, § 25; E. LATTY, *supra* note 149, at 220; Ballantine, *supra* note 149, at 18-19.

(3) The formal barriers between the two management structures should be maintained

(4) The two units should not be represented as being one unit.²⁷⁴

While stock control and common directors are generally prerequisites to the application of the enterprise theory, they are insufficient by themselves to warrant disregard of the separate identity of the controlled corporation.

Those familiar with present day methods of corporate control will not be so naive as to suppose that the complete domination in fact of its subsidiaries by a holding company owning all their stock is in any way inconsistent with scrupulous recognition of their corporate entities, or with maintenance of separate accounts and distinct personnel of officers and directors.²⁷⁵

The actual exercise of control is a much more important factor.²⁷⁶ It should be noted that even subsidiaries and affiliates that adhere to the foregoing guidelines would be assured of only general recognition as separate legal entities; they would not be considered sham corporations and the identity concept would not be applicable to them. It would not prevent, however, the application of the enterprise theory to specific transactions that are controlled by the controlling corporation or that are otherwise attributed to that corporation. One should keep in mind this distinction between the general application of the enterprise theory so as to negate the corporate identity completely, and the restricted application of the theory to specific situations. This restricted application of the theory might be termed partial disregard of the corporate identity; the terminology used notwithstanding, the end result is the attribution of an act to a single economic enterprise.

In many cases the entity status has been denied for contract or tort purposes if the subsidiary or affiliate was inadequately capitalized.²⁷⁷ Courts have also given effect to the enterprise theory in

274. Douglas & Shanks, *Insulation from Liability through Subsidiary Corporations*, 39 YALE L.J. 193, 196-97 (1929).

275. *United States v. Elgin, Joliet & E. Ry.*, 298 U.S. 498, 506 (1936) (Stone, J., dissenting).

276. See *Zaist v. Olson*, 154 Conn. 563, 575, 227 A.2d 552, 558 (1967); text accompanying note 270 *supra*. For a discussion of factors other than control which will support a finding of separation, see *Markow v. Alcock*, 356 F.2d 194 (5th Cir. 1966).

277. See *Herman v. Mobile Homes Corp.*, 317 Mich. 233, 26 N.W.2d 757 (1947); E. LATTY, *supra* note 149, at 119-41; Comment, *Inadequately Capitalized Subsidiaries*, 19 U. CHI. L. REV. 872 (1952); Annot., 63 A.L.R.2d 1051 (1959). See also Comment, *Alternative Methods of Piercing the Corporate Veil in Contract and Tort Cases*, 48 B.U. L. REV. 123 (1968); Comment, *Disregarding the Corporate Entity: Contract Claims*, 28

going behind the corporate structure to reach the single economic entity for narrow purposes. Thus, a Canadian bank and its French subsidiary have been treated as one entity for service of process purposes;²⁷⁸ two corporations were permitted to maintain a joint action to recover consequential damages for injury to one corporation's property caused by the taking of the affiliate's property;²⁷⁹ a court held that a parent corporation could be liable for debts incurred by its subsidiary prior to dissolution of the subsidiary;²⁸⁰ and an individual stockholder and a sister corporation were held liable for services and materials provided to a brother corporation.²⁸¹ Furthermore, when multiple corporations are used to avoid obligations under a collective bargaining contract²⁸² or to avoid back-pay orders,²⁸³ the courts will look to the economic unit to avoid defrauding creditors or circumventing contractual obligations.

A recent development important to the MNE is legislation directed toward regulating groups of companies.²⁸⁴ These legislative innovations suggest that governing authorities, in addition to courts, will occasionally ignore the distinct entity concept and instead view the corporate network as a single economic entity.²⁸⁵ The rationale for this departure from traditional doctrine is a desire to protect the interests of third parties and minority stockholders. It is submitted

OHIO Sr. L.J. 441 (1967); Annot., *supra* note 262 (contracts); Annot., 7 A.L.R.3d 1343 (1966) (torts). Cf. *Anderson v. Abbott*, 321 U.S. 349 (1944); *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307 (1939).

278. *Public Admr. of County of New York v. Royal Bank of Canada*, 19 N.Y.2d 127, 224 N.E.2d 877, 278 N.Y.S.2d 378 (1967). Similarly in *Taca Intl. Airlines, S.A. v. Rolls-Royce of England, Ltd.*, 15 N.Y.2d 97, 99, 204 N.E.2d 329, 329, 256 N.Y.S.2d 129, 130 (1965), an American subsidiary was held to be a "separately incorporated department or instrumentality" of a British parent company for service of process purposes.

279. *California Zinc Co. v. United States*, 72 F. Supp. 591 (Ct. Cl. 1947).

280. *Edwards v. Chicago & N.W. Ry.*, 79 Ill. App. 2d 48, 223 N.E. 2d 163 (1967).

281. *Zaist v. Olson*, 154 Conn. 563, 227 A.2d 552 (1967); *Luckenbach S.S. Co. v. W.R. Grace & Co.*, 267 F. 676 (4th Cir. 1920).

282. See, e.g., *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964); *Wirtz v. Ocala Gas Co.*, 336 F.2d 236 (5th Cir. 1964).

283. *NLRB v. Deena Artware, Inc.* 361 U.S. 398 (1960).

284. The major development in the area is the *AKTIENGESETZ*, the German Stock Company Act of 1965, with a whole set of rules to regulate many of the problems concerning related companies, *AKTG* §§ 291-338 (1965). See text accompanying notes 369-94 *infra* for a discussion of the new German law and text accompanying notes 395-426 *infra* for a discussion of the European company proposal. In England, the Companies Act of 1948, 11 & 12 Geo. 6, c. 38 §§ 150-54, introduced provisions requiring consolidated accounts from holding and subsidiary companies. Accordingly, the holding company's accounts have to produce a true statement of the affairs of the group as a whole. The Companies Act of 1967, c. 81, § 4, extended the requirements by including more companies within the scope of the regulations.

285. See, e.g., L. GOWER, *supra* note 162, at 216. See generally *id.* at 194-200, 213-17.

that this rationale for the application of the enterprise theory should be extended from the micro-level to the macro-level to protect not only private interests but also national interests such as fiscal²⁸⁶ and socio-economic policies.²⁸⁷ Furthermore, the enterprise theory should also be utilized in order to preserve the integrity of the MNE and its centralized control as long as application of the theory does not obstruct national policies; thus, the MNE's intercorporate arrangements should be exempt from certain prohibitions imposed on independent corporations.²⁸⁸

It has been stated that "[w]here it is necessary to do so in order to do justice, the courts have not infrequently disregarded the separate corporate entities and treated the two corporations as one."²⁸⁹ A survey of the cases, however, reveals that courts are very reluctant to look behind the corporate entity without clear proof of evasion or fraud. It is in the area of corporate taxation that this principle faces its most severe test.

2. Disregard of the Corporate Entity for Tax Purposes

The income tax statutes in most countries contain express provisions under which tax authorities may fully or partially disregard the separate existence of a corporation in a multicorporate structure if to do so is necessary to prevent tax avoidance or tax evasion.²⁹⁰ In the absence of express statutory authority to the contrary, a corporation is generally treated as an independent entity for tax purposes. Nevertheless, courts are not blind to economic realities and will disregard the corporate entity in order to defeat tax avoidance through

286. See notes 301-29 *infra* and accompanying text for the protection of fiscal interests.

287. See notes 348-68 *infra* and accompanying text for the protection of antitrust policies.

288. See text accompanying notes 330-37 *infra* for the exemption of the MNE's intercorporate arrangements from certain antitrust restrictions.

289. *California Zinc Co. v. United States*, 72 F. Supp. 591, 593 (Ct. Cl. 1947).

290. See, e.g., INT. REV. CODE OF 1954, § 482. Statutes also provide for special circumstances under which taxpayers may elect to disregard a corporation for tax purposes. See, e.g., INT. REV. CODE OF 1954, §§ 1371-77, providing that the shareholders of certain small business corporations ("subchapter S corporations") may elect to disregard the corporate entity for tax purposes and thereby be taxed on their pro rata share of the income, an approach similar to the tax treatment of a partnership.

Other statutory provisions permit the entire economic enterprise to be treated as one taxable entity notwithstanding the number of individual corporate members. See, e.g., INT. REV. CODE OF 1954, § 1501, providing that an "affiliated group of corporations" may elect to file a single consolidated return for the whole group (enterprise). The result is that the enterprise is taxed in accordance with its consolidated taxable income, which reflects the transactions with unrelated entities and tends to ignore the intercompany dealings within the group. See Treas. Regs. § 1.1502-13 (1966).

the use of multiple corporations or in order to reach the real taxpayer in interest.²⁹¹ Thus, under long-established tax principles, courts will refuse to recognize a corporation as a distinct entity if it lacks economic reality and is a sham.²⁹²

Many cases in this area involve an artificial multicorporate structure formed principally for tax avoidance purposes. To distinguish between real and sham corporations, the courts have experimented with many tests including the "business activity" standard articulated by the Supreme Court in *Moline Properties, Inc. v. Commissioner*.²⁹³ Recognizing that a corporation might be organized for a variety of reasons, the Court stated that "so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity."²⁹⁴ A variant of the business activity standard is the tax avoidance doctrine, which, in the words of Judge Learned Hand, provides "that to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation."²⁹⁵

The theories applied by the tax courts are analogous to the agency and enterprise theories applied to determine corporate liability in other settings.²⁹⁶ For example, the tax court has held that the entire income of sixteen alphabet corporations was taxable to the controlling corporation because "they carried on no separate independent income-producing activities [and served no function other than avoiding taxes]. They were mere corporate shells acting as a conduit for [the controlling corporation]."²⁹⁷ Yet, in tax avoidance cases the courts prefer to apply tax principles or statutory provisions that allow taxation according to the reality of the enterprise instead of formally disregarding the corporate entity. For in-

291. An entity may, for example, be treated as a corporation for tax purposes even though it does not satisfy the formal requirements of a corporation for other legal purposes. An early attempt to summarize the leading cases in the area was made by Judge Learned Hand in *National Investors Corp. v. Hoey*, 144 F.2d 466, 467-68 (2d Cir. 1944).

292. *Higgins v. Smith*, 308 U.S. 473, 477 (1940).

293. 319 U.S. 436 (1943).

294. 319 U.S. at 439.

295. *National Investors Corp. v. Hoey*, 144 F.2d at 468. See generally B. BITTKER & J. EUSTICE, *supra* note 181, §§ 1.05, 2.10, 15.07; 7 J. MERTINS, *THE LAW OF FEDERAL INCOME TAXATION* §§ 38.07-.15 (1967, Supp. 1972); Chirelstein, *Learned Hand's Contribution to the Law of Tax Avoidance*, 77 YALE L.J. 440 (1968); Cleary, *The Corporate Entity in Tax Cases*, 1 TAX L. REV. 3 (1945); Watts, *Tax Problems of Regard for the Corporate Entity*, in 20 N.Y.U. INST. FED. TAX. 867 (1962).

296. See notes 252-89 *supra* and accompanying text.

297. *Aldon Homes, Inc. v. Commissioner*, 33 T.C. 582, 603 (1959).

stance, the controlling corporation cannot escape taxation by anticipatory attempts to divert income to another entity; income will be taxed to the party that earns it, and assignment of income will not be permitted.²⁹⁸ Under the long-standing judicial doctrine of sham transactions, transactions lacking economic substance and legal business purpose will be ignored for tax purposes.²⁹⁹ Illustratively, when a parent sold portfolio stock at a loss to its wholly owned subsidiary—and yet retained economic control over the property for fifteen years following the sale, the court held that the sale was invalid for tax purposes.³⁰⁰ The court did not challenge the separate corporate entity of the subsidiary and ignored only the sham intercompany sale. Thus, under these and other doctrines, the taxing authority is able to look at the substance rather than the form of income-producing activities without having expressly to disregard the corporate entity.

D. *Application of the Corporate Entity Concept to the Multinational Enterprise*

The foregoing legal principles that govern the recognition of the corporate entity are equally applicable to multinational business. Local courts may seek to reach the controlling corporation in a range of “exceptional cases” and for a variety of legal purposes. It is particularly in the tax and antitrust fields that national governments realize the importance of recognizing the entire economic unit of the MNE.

1. *Disregard of the Corporate Entity for International Tax Purposes*

a. *An overview of possible abuses by the multinational enterprise through transfer prices.* Tax revenues are an important economic benefit to the nations in which MNEs operate. Business operations of MNEs embrace many national tax jurisdictions resulting in multiple tax liabilities. Therefore, one of the major problems presented by the emergence of the MNE is the equitable allocation of

298. See *Harrison v. Schaffner*, 312 U.S. 579, 582 (1941); *Helvering v. Horst*, 311 U.S. 112 (1940); *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930); INT. REV. CODE OF 1954, §§ 269, 482, 1551, 1561.

299. See *Knetsch v. United States*, 364 U.S. 361 (1960); *Higgins v. Smith*, 308 U.S. 473 (1940); *Griffith v. Helvering*, 308 U.S. 355 (1939); *Gregory v. Helvering*, 293 U.S. 465 (1935); *Gilbert v. Commissioner*, 248 F.2d 399, 410 (2d Cir. 1957); *National Investors Co. v. Hoey*, 144 F.2d 466 (2d Cir. 1944).

300. *National Lead Co. v. Commissioner*, 336 F.2d 134 (2d Cir. 1964).

its income—and its income taxes—among the participating states. The challenge to world tax systems is to promote the efficient operation of the MNE in a manner that will not distort the proper allocation of resources by tax avoidance (underlap) or subject MNEs to double taxation (overlap).³⁰¹

This objective is made difficult because the MNE has the power to allocate its income and expenses among its corporate members around the world. The principal means by which this is accomplished is the intercompany (intraenterprise) transaction.³⁰² Because such transactions are controlled by the same party in interest, the prices charged do not necessarily reflect the prices that would have been charged between the MNE and an unrelated business. The existence of this manipulative power has caused nation-states to monitor closely these allocation decisions.

The most important type of intercompany transaction in the manufacturing and extractive industries is the intercompany sale of goods.³⁰³ “Intercompany sales are the single most important method effecting movement of capital between countries in which [an MNE operates].”³⁰⁴ These include sales of finished and unfinished goods, components, equipment, and supplies between the parent company and its foreign subsidiaries, and between affiliates of the MNE.

Assuming other relevant variables are constant, an MNE maximizes worldwide after-tax profitability by transferring its goods at a relatively low price to subsidiaries in nations that have relatively low corporate tax rates.³⁰⁵ Similarly, the MNE will maximize after-tax profits if it buys goods at relatively high prices from its affiliates that are subject to comparatively low corporate tax rates. The price at which the MNE sells goods or services from one member of the enterprise to another is called the transfer price. Insofar as intercompany sales and transfer prices determine the jurisdiction in which profits are taxed and the level of income produced, local tax authorities are concerned. As a result, tax authorities may challenge an

301. C. KINDLEBERGER, *supra* note 1, at 201.

302. The term “intraenterprise transaction” is technically more accurate since not all of the components of the MNE are distinct corporate entities; nonetheless, the term “intercompany transaction” is commonly used in this context. The two terms will be used interchangeably throughout this Article and will refer to transactions between two corporations within the MNE, or between a corporation and a branch, or between two branches of the MNE.

303. J. GREENE & N. DUERR, *INTERCOMPANY TRANSACTIONS IN THE MULTINATIONAL FIRM* 21 (1970) (survey by the National Industrial Conference Board) [hereinafter J. GREENE & N. DUERR].

304. D. ZENOFF & J. ZWICK, *INTERNATIONAL FINANCIAL MANAGEMENT* 427-30 (1969) [hereinafter D. ZENOFF & J. ZWICK]. See text accompanying notes 21-23 *supra*.

305. D. ZENOFF & J. ZWICK, *supra* note 304, at 427-30.

MNE's transfer prices and seek to substitute the price at which the goods would have been sold to outsiders.³⁰⁶ Although the potential abuses of intercompany sales have been recognized, empirical evidence documenting the actual use of the transfer-price mechanism to shift profits between countries is vague and contradictory.³⁰⁷

The propensity to use intercompany sales to allocate income may be dependent on the size of an enterprise. Thus, smaller firms may lack the international experience or be so decentralized that the coordination necessary to avoid taxes is lacking.³⁰⁸ Medium-size firms, large enough to possess the requisite planning sophistication, are generally sufficiently centralized to develop the system necessary for such a tax avoidance strategy.³⁰⁹ While the incidence of intercompany sales by these MNEs is not inconsequential, national governments are understandably more concerned with the large MNEs that are economically more important than the other two groups.³¹⁰ A number of factors reveal that the large MNEs may not be able to engage in widespread effective use of intercompany sales to manipulate allocation of income. First, at some point the MNE becomes so large that effective coordination is impossible.³¹¹ It has already been noted that very large MNEs are decentralizing in order to retain the necessary sensitivity to localized markets;³¹² this same decentralization makes it difficult to pursue any widespread policy of intercompany sales to circumvent tax laws. Second, even if sophisticated managerial and financial tools would permit such a program, the MNE, with its substantial investment in the host country, has a strong incentive not to jeopardize its relationship with that country's government.³¹³ Third, although financial manipulation can result in large dollar savings, "such savings are small in relation to the earnings received from capitalizing on [its] special strengths such as technical know-how, managerial and marketing expertise, or capacity to raise large sums of money."³¹⁴

306. J. GREENE & N. DUERR, *supra* note 303, at 21-24.

307. *See generally id.* It has been suggested that the use of these manipulative devices has been overestimated. Stobaugh, *The Multinational Corporation: Measuring the Consequences*, 6 COLUM. J. WORLD BUS., Jan.-Feb. 1971, at 59, 62 [hereinafter Stobaugh]. These observations were based on the Harvard Business School Study of the MNE.

308. *See* Stobaugh, *supra* note 307, at 59.

309. *See id.*

310. *Id.*

311. *Id.*

312. *See* text accompanying notes 113-17 *supra*.

313. Stobaugh, *supra* note 307, at 62.

314. *Id.*

b. *The response of nation-states to tax avoidance schemes of the multinational enterprise.* The attitude taken by nation-states through their legislatures and courts in the international context mirrors the diversity of techniques used in the domestic context. The experience of the United States and the United Kingdom are illustrative. The United States Tax Court has held that a foreign corporation that is merely a conduit could not avail itself of an otherwise applicable tax treaty,³¹⁵ yet that same court refused to disregard the corporate entity of foreign subsidiaries that were found to be viable business entities—despite the fact that they were created in tax haven countries in order to reduce taxes.³¹⁶ This partial disregard of the foreign entity could have been achieved under other tax principles, such as allocation of a portion of the subsidiary's income to the parent corporation. Such an allocation of the income of related corporations is possible under present statutory authority "in order to prevent evasion of taxes or clearly to reflect the income"³¹⁷ of each entity; taxable income will be determined as if the taxpayer had dealt with the other member of the enterprise at arm's length.³¹⁸

315. *Aiken Indus. v. Commissioner*, 56 T.C. 925 (1971). The court held that interest paid to a Honduras corporation by a United States corporation organized to collect such interest on behalf of a Bahamian corporation, was not exempt from United States withholding tax under the United States-Honduras income tax treaty. See *Johansson v. United States*, 336 F.2d 809 (5th Cir. 1964), for an attempt by a Swedish individual to avail himself of the United States-Swiss tax treaty by organizing a Swiss corporation.

316. In *Bass v. Commissioner*, 50 T.C. 595 (1968), a controlled Swiss company was held to be a viable corporate entity notwithstanding the fact that it was organized to reduce taxes on oil income under the United States-Swiss tax treaty. In *Johnson Bronze Co. v. Commissioner*, 34 P-H TAX CT. REP. & MEM. DEC. ¶ 65,281 (Oct. 26, 1965), the court refused to include the income of a Panamanian selling subsidiary (an intermediate holding company) in the income of the United States parent corporation. The court upheld the subsidiary's existence as a separate taxable entity on the ground that it served a bona fide purpose by insulating the parent company from the various risks of foreign operation, despite the fact that all managerial and clerical work was performed for it by the parent corporation, the subsidiary had no employees, paid no salaries, owned no offices or office equipment, and had no warehouse. In *Columbian Rope Co. v. Commissioner*, 42 T.C. 793 (1964), the court held that undistributed income of a wholly owned Panamanian subsidiary created by a United States parent for valid business purposes was not includable in the parent's taxable income, citing *Moline Properties* as the basis for its decision. The taxable years in question were prior to the Revenue Act of 1962, which provided that certain types of income of controlled foreign corporations were to be included in the income of the United States parent in the year that the income was earned, even if the income was undistributed. INT. REV. CODE OF 1954, §§ 951-64.

317. INT. REV. CODE OF 1954, § 482. Such a partial allocation of income was made in *Johnson Bronze Co. v. Commissioner*, 34 P-H TAX CT. REP. & MEM. DEC. ¶ 65,281 (Oct. 26, 1965), following the refusal of the court to disregard the corporate form of the foreign subsidiary or to attribute its whole income to the United States parent under the "assignment of income" doctrine.

318. Treas. Reg. § 1.482-1(b)(1) (1968).

The English response to this problem has differed from the American approach. Early British tax decisions held that business carried on by subsidiaries incorporated in the United States was in fact carried on by English parent companies; the subsidiaries were viewed merely as agents of their English parents.³¹⁹ Later cases established that mere ownership of a subsidiary did not assure that the subsidiary's business was in fact controlled in the United Kingdom. Thus, British courts will recognize the separate corporate entity of a subsidiary if its business is not in fact managed by the British parent company,³²⁰ unless it is revealed that the subsidiary is essentially an agent of the parent.³²¹

However, even if the foreign subsidiary is found to be a separate entity, British tax law will still tax the income of the subsidiary if it is a "resident" of the United Kingdom. Although a domestic corporation is defined under United States tax law as a corporation "created or organized in the United States or under the law of the United States or of any State or Territory,"³²² British case law developed the theory that "a company resides for purposes of income tax where its real business is carried on And the real business is carried on where the central management and control actually abides."³²³ Obviously, the place of management and control does not necessarily coincide with the country of incorporation. This judicial test for determining tax residence is now articulated in the British tax statute.³²⁴

Thus, under British law a company may be incorporated in the United Kingdom but avoid being a resident for tax purposes,³²⁵ and

319. *Apthorpe v. Peter Schoenhofen Brewing Co.*, 4 Tax Cas. 41 (C.A. 1899); *St. Louis Breweries, Ltd. v. Apthorpe*, 4 Tax Cas. 111 (Q.B. 1898); *United States Brewing Co. v. Apthorpe*, 4 Tax Cas. 17 (Q.B. 1898); *Frank Jones Brewing Co. v. Apthorpe*, 4 Tax Cas. 6 (Q.B. 1898).

320. *Gramophone & Typewriter, Ltd. v. Stanley*, [1908] 2 K.B. 89 (C.A.); *Kodak, Ltd. v. Clark*, [1903] 1 K.B. 505.

321. *See Unit Constr. Co. v. Bullock*, [1960] 38 T.C. 712.

322. INT. REV. CODE OF 1954, § 7701(a)(4). The place of incorporation is also provided by the United States tax treaties as the criterion for citizenship of United States corporations. *See, e.g.*, Treaty with Germany on Double Taxation of Income, July 22, 1954, art. II(1)(c), [1954] 3 U.S.T. 2768, T.I.A.S. No. 3133 (effective Dec. 20, 1954).

323. *De Beers Consol. Mines, Ltd. v. Howe*, [1906] A.C. 455, 458 (H.L.).

324. Income and Corporation Taxes Act of 1970, c. 10, § 482(7). *See also* Israeli Income Tax Ordinance § 1.

325. *Egyptian Delta Land & Inv. Co. v. Todd*, [1929] A.C. 1 (H.L.). However, the United Kingdom Treasury is protected against migration of the corporate management abroad by a statutory provision making it illegal to move without government consent. Income and Corporation Taxes Act of 1970, c. 10, § 482.

a company incorporated abroad may be subject to British taxes.³²⁶ Generally speaking, if a company's business is controlled by its directors, that business will be considered to be carried on where the board of directors meets. If the directors of the subsidiary meet abroad and manage and control its business there, it will not be a resident of the United Kingdom; but, if the subsidiary's business is in fact managed and controlled by the board of directors of the parent company in the United Kingdom, the subsidiary will also be a resident of the United Kingdom for tax purposes.³²⁷

The foregoing tax cases reveal that, while the domestic concepts of the corporate entity apply to MNEs, additional principles sensitive to the peculiarities of international business have also evolved to cope with controlled corporations. Such principles are not necessarily incompatible with recognition of the separate legal personality of each related entity, but they do protect the national interests in financial integrity by looking through corporate form in order to reach the economic essence of the enterprise. Thus, the British ascertain the locus of "control" and "management" as the determinative factor of tax liability, and thereby reach certain enterprises that might escape American tax. The United States moved to protect its financial interest in 1962 by amending the Internal Revenue Code to provide that income earned by American-controlled tax haven companies would be taxed to American stockholders in the year earned, rather than postponing taxation until remittance of income to the United States.³²⁸ In addition, the United States has vigorously enforced its statutory authorization, by reallocation of income among related entities, to prevent manipulation of income.³²⁹

This brief survey of the responses by two countries to the tax problems caused by the MNE demonstrates the desperate attempt being made by nation-states to thwart tax avoidance. The law in this area remains uncertain as countries continue the search for a satisfactory regulatory scheme.

326. *De Beers Consol. Mines, Ltd. v. Howe*, [1906] A.C. 455 (H.L.).

In a particular instance, a company may be found to be a resident of more than one country if its management and control are so divided. See *Swedish Cent. Ry. v. Thompson*, [1925] A.C. 495 (H.L.).

327. *Unit Constr. Co. v. Bullock*, [1960] A.C. 351 (H.L.) (subsidiaries incorporated in Kenya were held to be residents of the United Kingdom).

328. INT. REV. CODE OF 1954, §§ 951-64. See Tillinghast, *United States Income Taxation of Foreign Source Income: A Survey of the Provisions and Problems*, in 29 N.Y.U. INST. FED. TAX 1 (1971). See text accompanying notes 175-77 *supra*.

329. INT. REV. CODE OF 1954, § 482. A somewhat similar provision of the British Income and Corporation Taxes Act of 1970, c. 10, § 485, has not been vigorously enforced.

2. *The Corporate Entity as a Limitation on Antitrust Regulation*

a. *Intercorporate arrangements.* The interconnected corporate network of the MNE provides interesting conceptual and practical problems in the restrictive practices and antitrust field. It is in this area that the clash between the form of business enterprise and the underlying economic unity is clearest. When recently presented with a territorial division agreement between a foreign parent company and its wholly owned subsidiaries in different member states, which probably would have violated the antitrust provisions of the EEC Treaty agreement if it had been between unrelated companies, the Commission of the European Common Market nevertheless approved it.³³⁰ The Commission viewed the MNE as a single economic entity despite the separate legal entities used to conduct its business.³³¹ Emphasizing the control by the parent,³³² the Commission concluded that "[u]nder these circumstances, it cannot be expected that one part of this entity—even though it has a separate legal personality—will compete with the parent company."³³³

Last year, the EEC Commission applied the same theory to other MNEs such as the American-based Eastman Kodak Company.³³⁴ The Commission held:

Where the subsidiaries concerned, as in this case, depend exclusively and completely on their parent company and where this parent

330. *Christiani & Nielsen N.V.*, 12 E.E.C. J.O. L165/12 (1969), [1965-1969 New Developments Transfer Binder] CCH COMM. MKT. REP. ¶ 9308 (June 18, 1969). The decision involved a Danish-based MNE with wholly owned subsidiaries in several EEC countries.

331. The Commission was aware of the economic attributes of the MNE and the presence of this new business form of conducting transnational business. It stated:

For reasons of management, this enterprise, whose activities are international, formed subsidiaries in various countries rather than establish branches or agencies. What is involved here is an element of market strategy that does not result in the conclusion that, in this case, a wholly-owned subsidiary is an economic entity that can compete with its parent company.

12 E.E.C. J.O. L165/at 14, [1965-1969 New Developments Transfer Binder] CCH COMM. MKT. REP. ¶ 9308, at 8659.

332. Furthermore, *Christiani & Nielsen*, Copenhagen, has a right to appoint the managers of *Christiani & Nielsen, The Hague*, and to give its subsidiary instructions that it must follow. *Christiani & Nielsen, The Hague*, is therefore an integral part of the economic whole of *Christiani & Nielsen* group.

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The division of markets provided for in the agreement [between the parent and the subsidiary] is, therefore, only a division of labor within the same economic entity.

12 E.E.C. J.O. L165/at 14, [1965-1969 New Developments Transfer Binder] CCH COMM. MKT. REP. ¶ 9308, at 8659.

333. 12 E.E.C. J.O. L165/at 14, [1965-1969 New Developments Transfer Binder] CCH COMM. MKT. REP. ¶ 9308, at 8659.

334. 13 E.E.C. J.O. L147/24, [New Developments] 2 CCH COMM. MKT. REP. ¶ 9378 (July 2, 1972).

company effectively exercises its power of supervision by giving exact instructions, it is impossible for the subsidiaries to act independently of each other in the areas which the parent company controls.³³⁵

Accordingly, when the MNE affiliates in fact constitute a single economic entity, intra-MNE arrangements do not violate the EEC law as long as they do not involve restrictive arrangements with unrelated third parties.³³⁶ But, MNEs that decentralize their marketing decisions and, despite the legal control over the subsidiaries, do not instruct affiliates as to marketing and pricing behavior, might still be subject to the antitrust laws in their intercorporate dealings; the reason for such a distinction is that such affiliates might be viewed and expected to act as competitors.³³⁷

Whether the United States would apply this single enterprise theory is highly questionable. Various statements by the courts reveal a preoccupation with corporate form. In a recent illustrative case, *Perma Life Mufflers, Inc. v. International Parts Corp.*,³³⁸ a parent corporation and its subsidiaries were charged with restraints of trade. The court of appeals affirmed the district court's finding that all the parties were part of a "single business entity"³³⁹ and therefore no conspiracy existed as a matter of law. Citing its earlier decision in *Timken Roller Bearing Co. v. United States*,³⁴⁰ the Supreme Court reversed and held that

since respondents Midas and International [the subsidiary and the parent] availed themselves of the privilege of doing business through separate corporations, the fact of common ownership could not save them from any of the obligations that the law imposes on separate entities.³⁴¹

In *Timken*, the Court had announced that "[t]he fact that there is common ownership or control of the contracting corporations does

335. 13 E.E.C. J.O. L147/at 25, [New Developments] 2 CCH COMM. MKT. REP. ¶ 9378, at 8819.

336. Therefore, the sales conditions agreed upon between Kodak companies and their various buyers did not come within the scope of the antitrust provisions of Article 85 of the EEC Treaty. 13 E.E.C. J.O. L147/at 24-25, [New Developments] 2 CCH COMM. MKT. REP. ¶ 9378, at 8819-20.

337. For the EEC policy in this context, see generally Dietz, *Enforcement of Anti-Trust Laws in the EEC*, 6 INTL. LAW. 742 (1972); Forcione, *Intra-Enterprise Conspiracy Under the Antitrust Regulations of the Common Market*, 25 BUS. LAW. 1419 (1972).

338. 392 U.S. 134 (1968).

339. 376 F.2d 629, 699 (7th Cir. 1967).

340. 341 U.S. 593 (1951).

341. 392 U.S. at 141-42.

not liberate them from the impact of antitrust laws."³⁴² A distinction the Court had failed to recognize was that *Perma Life* involved in reality a single business entity whereas *Timken* concerned an international joint-venture.³⁴³

It is submitted that enforcement agencies and courts should recognize that the various components of an MNE cannot be expected to behave as if they were unrelated. The separate corporate personality of each unit of the MNE should not be determinative if in a business and economic sense the entities act as a unified enterprise; to treat an MNE differently depending on whether its business is conducted through incorporated or unincorporated units³⁴⁴ is an unjustified deference to form over substance.³⁴⁵ It is unrealistic to expect—or require—wholly owned affiliates to compete with each other as unrelated companies.³⁴⁶ This is particularly true when the motivation for incorporation serves a valid commercial purpose, such as compliance with foreign law requiring local incorporation, a

342. 341 U.S. at 598. See also *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 215 (1951); *United States v. Yellow Cab Co.*, 332 U.S. 218, 227 (1947).

343. The court of appeals indicated that *Perma Life's* affiliates did not hold themselves out as competitors but rather as related members of the same enterprise. 376 F.2d at 699. This is an important point since related corporations that hold themselves out as competitors should be subject to the antitrust rules in their intercorporate dealings. *Kiefer-Stewart* involved such a factual arrangement. *Perma Life* was decided on the pleadings, and at any rate the decision could be justified on antitrust theories other than the intraenterprise restrictive arrangements. See 392 U.S. at 142.

344. The United States-based Timken Company acquired complete ownership of its foreign subsidiaries and converted them into unincorporated divisions. At that stage the United States Department of Justice approved Timken's intracorporate business arrangements. Markley, *How Timken Coordinates Its Worldwide Manufacturing and Marketing*, EXPORT TRADE, April 25, 1960, at 10. A change of attitude by the Justice Department concerning the arrangements between wholly owned subsidiaries and their companies would be advisable, as long as these entities behave like members of a single enterprise, since they in fact all belong to the same MNE. See also *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 215 (1951); *Joseph E. Seagram & Sons, Inc. v. Hawaii Oke & Liquors, Ltd.*, 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970).

345. As Justice Jackson correctly noted in his dissent in *Timken* at 341 U.S. at 606: It is admitted that if Timken had, within its own corporate organization, set up separate departments to operate plants in France and Great Britain, as well as in the United States, "that would not be a conspiracy. You must have two entities to have a conspiracy." Thus, although a single American producer, of course, would not compete with itself, either abroad or at home, and could determine prices and allot territories with the same effect as here, that would not be a violation of the Act because a corporation cannot conspire with itself The doctrine now applied to foreign commerce is that foreign subsidiaries organized by an American corporation are "separate persons," and any arrangement between them and the parent corporation to do that which is legal for the parent alone is an unlawful conspiracy. I think that result places too much weight on labels.

346. ANTITRUST LAWS, *supra* note 178, at 36 (1955).

managerial decision to reduce risk, or compliance with particular tax regulations. As *The Attorney General's National Committee To Study the Antitrust Laws* admitted in 1955—only four years after *Timken*:

The use of subsidiaries is generally induced by normal, prudent business considerations. No social objective would be attained were subsidiaries enjoined from agreeing not to compete with each other or with their parent. To demand internal competition within and between the members of a single business unit is to invite chaos without promotion of the public welfare.³⁴⁷

b. *Antitrust jurisdiction over the multinational enterprise.* Although the United States has not applied the enterprise theory to exempt an MNE from the substantive reach of the antitrust laws, it has applied an analogous theory to subject the parent company of the MNE to local jurisdiction despite the fact that the anticompetitive activities were arranged in the home country and in fact only carried on by the foreign entities of the MNE. Until recently, the United States was the only country to apply this so-called "effect" theory, under which it has been able to apply American law to the activities abroad of foreign companies. In *United States v. Aluminum Co. of America*,³⁴⁸ the famous *Alcoa* case, Judge Learned Hand asserted that it is "settled law . . . that any State may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders

347. *Id.* at 34. See, e.g., *United States v. Arkansas Fuel Oil Corp.*, 1960 Trade Cas. ¶ 69,619 (N.D. Okla. 1960); Handler, *Through the Antitrust Looking Glass—Twenty-First Annual Antitrust Review*, 57 CALIF. L. REV. 182 (1969); Willis & Pitofsky, *Antitrust Consequences of Using Corporate Subsidiaries*, 43 N.Y.U. L. REV. 20 (1968). See also *Cliff Food Stores, Inc. v. Kroger, Inc.*, 417 F.2d 203 (5th Cir. 1969); *Allan Ready Mix Concrete Co. v. John A. Denie's Co.*, 5 TRADE REG. REP. (1972 Trade Cas.) ¶ 73,955 (D.C. Tenn. April 13, 1972). But see *Phi Delta Theta Fraternity v. J.A. Buchroeder & Co.*, 251 F. Supp. 968 (W.D. Mo. 1966).

Wilbur Fugate, Chief Foreign Commerce Section, Antitrust Division, United States Department of Justice, stated recently that *Timken* is still good law but that the recommendations of the 1955 Attorney General's Committee should be followed in regard to wholly owned foreign subsidiaries of United States MNEs and activities based on corporate control, but not to those based on contractual agreements. Remarks at the Multinational Enterprise Seminar of the World Trade Institute, New York, Oct. 25, 1972, 5 CCH TRADE REG. REP. ¶ 50,152, at 55,258-59. He concluded that

[u]nder present U.S. antitrust law, a U.S. company may usually exercise its control over a foreign subsidiary to direct the subsidiary in matters of pricing and sales areas. The antitrust laws, however, may apply to intra-corporate dealings where third parties are injured or monopolization is present.

Id. at 55,262. The EEC Commission gave its negative clearance to an intra-MNE express agreement not to compete in *Christiani & Nielsen N.V.*, 12 E.E.C. J.O. L165/12 (1969). See notes 330-33 *supra* and accompanying text.

348. 148 F.2d 416 (2d Cir. 1945).

that has consequences within its borders which the State reprehends"³⁴⁹ Although the full reach of this theory is uncertain, the United States courts have applied this theory whenever the foreign corporation intended to affect United States commerce and such adverse effect has occurred.³⁵⁰

Although American law has not been specifically addressed to MNEs, most cases involving extraterritorial application of the United States antitrust law have dealt with restrictive activities conducted abroad by foreign companies that were affiliated with local corporations. For example, *United States v. Watchmakers of Switzerland Information Center, Inc.*³⁵¹ dealt with concerted anticompetitive conduct abroad by Swiss parent companies that controlled their United States subsidiaries. Even the *Alcoa* case involved related foreign and American corporations.³⁵² However, the United States courts have not expressly invoked the enterprise theory to hold foreign companies liable for antitrust violations for the actions of their local affiliates or vice versa. Instead, they have proceeded on the basis of the effect of the foreign restrictive activities on domestic competition.³⁵³

349. 148 F.2d at 443. The controversy that has raged ever since this decision suggests that the law is hardly "settled." See, e.g., INTERNATIONAL LAW ASSOCIATION, REPORT OF THE FIFTY-FIRST CONFERENCE 304-592 (1964), esp. Riedweg, *The Extra-Territorial Application of Restrictive Trade Legislation—Jurisdiction and International Law*, id. at 357; Oliver, *The Harmonization of Laws and the Development of Principles for the Resolution of Conflicts of Enforcement Jurisdiction*, id. at 511; COMMON MARKET AND AMERICAN ANTITRUST 364-416 (J. Rahl ed. 1970) [hereinafter J. Rahl].

350. J. Rahl, *supra* note 349, at 86. The RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965) adopted, with several modifications, the "effect" theory as a basis for substantive international jurisdiction.

351. 5 TRADE REG. REP. (1963 Trade Cas.) ¶ 70,600 (S.D.N.Y. Dec. 20, 1962), *order modified*, 5 TRADE REG. REP. (1965 Trade Cas.) ¶ 71,352 (S.D.N.Y. Jan. 7, 1965).

352. The foreign company "Limited" was organized in Canada to take over the properties of the United States "Alcoa" that were located abroad. Limited issued all its common stock to Alcoa's common shareholders. 148 F.2d at 439. There were several indications that Limited and Alcoa did not deal with each other at arm's length and that Alcoa took part in the formation of "Alliance," the foreign cartel in question. 148 F.2d at 440. One commentator suggested that Judge Hand's effect theory was an attempt "to reverse, on grounds of law, a result below which he found unpalatable but did not want to remand for lengthy retrial on the facts." K. BREWSTER, ANTITRUST AND AMERICAN BUSINESS ABROAD 72 (1958). The questionable point of fact was whether Alcoa actually did participate in the foreign cartel; the lower court had found that Alcoa had not. In addition to the element of common control and the fact that Alcoa and Limited were affiliated companies, Limited's international headquarters was in New York, not Canada. *Id.* at 73.

353. Thus, in the noted *Watchmakers* case the court applied the effect theory stating that "a United States court may exercise its jurisdiction as to acts and contracts, if, as in the case at bar, such acts and contracts have a substantial and material effect

By contrast, the EEC Court of Justice, in the landmark *Dyestuff* decisions,³⁵⁴ invoked the enterprise theory in order to subject foreign-based MNEs to its jurisdiction. The Commission in this case³⁵⁵ had fined the Swiss companies—Ciba, Geigy, and Sandoz—and the British Imperial Chemical Industries (ICI), along with some EEC companies because of the concerted price-fixing of dyestuffs within the Common Market. The Court of Justice upheld the Commission on the applicability of the EEC antitrust law to the foreign companies. The Commission and the court fined the foreign parent companies, rather than their Common Market subsidiaries that were the distributors of dyestuffs within the European Community and had formally performed the anticompetitive activities.

ICI contended vigorously that *it* had not performed these activities; ICI asserted that they were performed by its EEC subsidiaries. The court properly rejected this contention because of facts that revealed a highly controlled multinational corporate structure. The court stated:

The fact that the subsidiary [of ICI] has its own legal personality does not serve to rule out the possibility that its *conduct is attributable to the parent company*. This could be the case where the subsidiary, even though it has its own legal personality, does not independently determine its own market behavior but essentially follows the instructions given it by the parent company [ICI]. If the subsidiary does not in fact have autonomy in determining its course

upon our foreign and domestic commerce." 5 TRADE REG. REP. (1963 Trade Cas.) ¶ 70,600, at 77,457. In the same litigation, eight years earlier, the district court had held that the Swiss parent companies were present in the United States for service of process purposes through the activities of their joint American subsidiaries. 113 F. Supp. 40, 45 (S.D.N.Y. 1955).

354. Separate decisions relating to nine companies were released together. *Imperial Chem. Indus., Ltd. v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8161 (July 14, 1972); *Badische Anilin-und Soda-Fabrik AG v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8162 (July 14, 1972); *Farbenfabriken Bayer AG v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8163 (July 14, 1972); *J.R. Geigy v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8164 (July 14, 1972); *Sandoz AG v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8165 (July 14, 1972); *S.A. Française des matières colorantes v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8166 (July 14, 1972); *Casella Farbwerke Mainkur AG v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8167 (July 14, 1972); *Farbwerke Hoechst v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8168 (July 14, 1972); *Azienda Colori Nazionali v. Commission of the European Communities*, 2 CCH COMM. MKT. REP. ¶ 8169 (July 14, 1972).

In reference to the jurisdictional issue, the cases are basically the same; thus specific citations will be given only to the ICI case.

355. 12 E.E.C. J.O. L195/11 (1969), CCH COMM. MKT. REP. ¶ 9314 (July 24, 1969).

of conduct on the market, the prohibition of Article 85, paragraph 1 [of the EEC Treaty], is inapplicable to the relationship between it and the parent company with which it forms an economic unity. Since an affiliated group, so structured forms a unity, the parent company can, under certain circumstances, be held responsible for the actions of the subsidiary.³⁵⁶

The parent company had both the legal control over the subsidiaries and the effective organizational control over certain activities of the subsidiaries.³⁵⁷ The decision-making power with respect to the pertinent conduct of the subsidiaries was centralized at the parent's level and had not been delegated: "The plaintiff [ICI] could decisively influence the pricing policy of its subsidiaries in the Common Market and it did in fact make use of this power to give instructions on the occasion of the three price increases in question here."³⁵⁸ Accordingly, the illegal conduct within the Common Market was viewed as conduct of the enterprise as a whole—conduct of a single economic unit consisting of both the parent company and the subsidiary, which were recognized as distinct legal entities—and attributed to the parent that originated the conduct.³⁵⁹

The court looked at the entire corporate network of the MNE to determine where the authority to make the pertinent pricing policy decisions resided. Once it was established that this power lay with the parent company and that "[b]y availing itself of its power of direction over its subsidiaries established in the Common Market, plaintiff [the parent ICI] was able to apply its decisions on that [EEC] market,"³⁶⁰ it followed that the prohibited practices were therefore

356. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8031 (emphasis added).

357. See text accompanying notes 152-60 *supra* for these two dimensions of control.

358. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8031.

359. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8031. The British government protested the Commission's original assertion of jurisdiction stating:

[T]he separate legal personalities of a parent company and its subsidiary should be respected. Such concepts as "enterprise entity" when applied for the purpose of asserting personal jurisdiction over a foreign parent company by reason of the presence within the jurisdiction of a subsidiary (and a foreign subsidiary by reason of the presence of its parent company) are contrary to sound legal principle in that they disregard the distinction of personality between parent and subsidiary.

Statement of Principles According To Which, in the View of the United Kingdom Government, Jurisdiction May Be Exercised over Foreign Corporations in Anti-trust Matters, in INTERNATIONAL LAW ASSOCIATION, REPORT OF THE FIFTY-FOURTH CONFERENCE 184 (1970).

360. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8031.

"carried out directly within the Common Market"³⁶¹ by the parent ICI. As a result, the court flatly rejected the plea of lack of EEC jurisdiction raised by ICI.³⁶² The EEC thus recognized, for antitrust purposes, the local business operation of ICI as an integral part of the larger enterprise controlled abroad. The court employed the enterprise theory³⁶³ to attribute the acts of the subsidiaries to the controlling corporation of the enterprise—the parent company.

By invoking the enterprise theory, the court held that the activities of the foreign parent company were carried out within and not outside the Common Market. In so holding, the court avoided the discussion of the controversial effect theory, namely, whether actions performed outside the EEC by foreign companies are subject to EEC jurisdiction solely because these actions had effects within the Common Market. Accordingly, the court did not have to respond to the lengthy arguments by ICI, supported by the expert opinion of Professor Jennings, that basing jurisdiction solely on the effect theory is contrary to international law.³⁶⁴ It is submitted that the court rightly rejected the contention that ICI could not be considered as having acted within the EEC through the activities of its subsidiaries in the Community.³⁶⁵ It is true that not every activity of wholly controlled subsidiaries may be imputed to the parent; but, notwithstanding the separate legal personalities of the subsidiaries, activities that the evidence reveals were in fact performed according to the instructions of the parent may be attributed to the parent under the enterprise theory.³⁶⁶

The court's decision is consistent with earlier Commission decisions that the antitrust prohibitions are not applicable to the rela-

361. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8031.

362. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8031.

363. See notes 265-89 *supra* and accompanying text.

364. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8005-06.

365. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8005-06. The effect theory should be considered primarily in cases involving foreign companies without local affiliates, or when the members of the MNE do not actually comprise a single economic unit with respect to the activities under consideration. However, most cases have involved local members of MNEs in a highly controlled structure. See notes 351-53 *supra* and accompanying text. Therefore, the enterprise theory may be properly applied to their activities.

366. See notes 270-71 *supra* and accompanying text. As the Commission put it before the court: "The thing to be determined here is that as to the practices involved here plaintiff's subsidiaries were mere tools, so that in competitive relations with third parties they appear to be an extension of I.C.I. in the Common Market." 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8007.

tions between the parent of the MNE and its subsidiaries as long as they in fact comprise a single economic enterprise.³⁶⁷ "Thus if the affiliated-group relationship can have favorable effects for enterprises in the application of Community cartel law, it would also have to be recognized that this relationship can also have unfavorable effects."³⁶⁸

E. *New Legal Models*

The uncertainty generated by judicial and legislative attempts to recognize the underlying economic unit of a multicorporate firm and to prevent frustration of national policies has led governments and international businesses to seek a more satisfactory legal framework around which MNEs may be constructed. Two recent developments have great relevance to this problem: the West German Law of Related Companies, and the proposals for a European company law.

1. *The German Law of Related Companies*

Passed in 1965, the German Law of Related Companies, the Konzernrecht,³⁶⁹ is a regulatory scheme that preserves the concept of the enterprise as a network of multiple legal entities within a single managerial framework. Nevertheless, the law is a good example of the needed shift in emphasis from the corporate form to the underlying economic enterprise. Like the MNE, the German Konzern is an economic unit consisting of a group of companies, related by ties of control extending into the separate legal entities. Whether the law will be applied to a particular enterprise depends upon actual or contractual control. Control may therefore be maintained, for example, by a majority of votes³⁷⁰ or by a contractual relationship by which an A.G. subordinates its managerial functions to the direction of another company or undertakes to transfer its total profits to another (the controlling) company.

Under this law, a Konzern is formed if a controlling and one or more controlled business units are subject to the centralized management of the controlling unit,³⁷¹ or if legal entities are subject to

367. See notes 330-33 *supra* and accompanying text.

368. 15 E.E.C. J.O. —, 2 CCH COMM. MKT. REP. ¶ 8161, at 8011 (referring to defendant's rejoinder).

369. AktG (1965). See text accompanying notes 194-99 *supra* for a discussion of two-tiered management under the AktG.

370. AktG § 16 (1965).

371. AktG § 18(1) (1965).

centralized management even though one does not control the other.³⁷² The Konzern thus includes (1) companies that are parties to a control agreement,³⁷³ under which separate companies agree in advance to be subject to the management of another—the controlling company,³⁷⁴ and (2) integrated companies.³⁷⁵ Integrated companies stand in a closer corporate relationship, even though there is no full merger eliminating the separate legal personalities of the companies. Instead, the integrated companies preserve their distinct juristic identities, although they constitute a single economic unit. Such integration becomes effective when a resolution to integrate into the German parent is passed by the shareholders of its wholly owned subsidiary and is approved by the shareholders of the parent.³⁷⁶

When there is a control agreement or a wholly owned integrated subsidiary, the law recognizes the power of the controlling company to direct the controlled companies, which may include instructions that result in particularized decisions that are detrimental to the latter, and permits the exercise of such power as long as directives are beneficial to the controlling entity or to the group of related companies (enterprise or Konzern) as a whole.³⁷⁷ However, the directors and officers of the controlling company may be liable for breach of the duty of due care in managing the controlled company.³⁷⁸ Thus, the Konzernrecht correctly perceives the shift of decision-making power from the controlled to the controlling entity pursuant to the control agreement or integration.³⁷⁹ Such a shift properly characterizes the decision-making process of many MNEs in important business determinations.³⁸⁰

The rationale of the law is to protect the shareholders of the controlled companies of the enterprise, as well as outsiders who do business with or otherwise invest in one of the enterprise's units.³⁸¹

372. AktG § 18(2) (1965).

373. AktG §§ 18(1), 291 (1965).

374. AktG § 291(1) (1965). A control agreement is but one type of "enterprise agreement" regulated by the Act. See AktG §§ 291-92 (1965).

375. AktG §§ 18(1), 319 (1965).

376. AktG §§ 319(1)-(2) (1965). Such an integration is recorded in the Commercial Register. AktG §§ 319(3)-(4) (1965).

377. AktG §§ 308, 323 (1965).

378. AktG §§ 309-10, 323 (1965).

379. See AktG § 308 (1965).

380. See text accompanying notes 119-21 *supra*.

381. See E. STEIN, *supra* note 147, at 105-07.

Thus, notwithstanding the fiction of the corporate veil, the controlling company may be liable to the controlled company's creditors or minority shareholders. The liabilities imposed depend on the type of control and whether there is a control agreement. Disregarding the corporate form, the law protects the minority shareholders and creditors from impairment of the controlled company's capital and profits.³⁸² Indeed, the law goes even further by imposing liability upon the controlling entity for losses sustained by the controlled company in certain circumstances.³⁸³

Where there is no control agreement or integration, a company which in effect controls another company, through stock ownership or otherwise, may not cause the controlled company to act or to refrain from acting to its disadvantage without compensation.³⁸⁴ Absent a control agreement or an integration, the law forces the affiliated companies to behave like unrelated companies. The law protects a controlled company against exploitation of its resources without adequate compensation, and requires extensive disclosures by the controlling company.³⁸⁵ The law requires dissemination of relevant financial information to the shareholders and the public, particularly with respect to intercompany transactions within the group of related companies.³⁸⁶

The increased emphasis on disclosure of information is further reflected by requirements imposed on entities whenever they acquire more than twenty-five per cent of all the shares of a German stock company. A business owning this requisite percentage must notify the issuer of this fact in writing; the investing entity must also notify the public if it acquires a majority interest or if its investment falls below the earlier reported quantum.³⁸⁷ These disclosure requirements are intended to protect shareholders, and failure to comply

382. See, e.g., AktG §§ 302, 309-10, 322(i) (1965).

383. AktG §§ 300-03, 324 (1965). In addition, a control agreement or an agreement to transfer profits must provide for fair compensation to, and for an offer to acquire the shares for adequate consideration from, the minority shareholders of the controlled company. AktG §§ 304-05 (1965).

384. AktG § 311 (1965).

385. AktG §§ 311, 312-15, 317-18 (1965).

386. AktG § 312 (1965). See AktG § 329 (1965) requiring consolidated financial statements and annual business reports of integrated companies or companies subject to a control agreement. See generally E. STEIN, *supra* note 147, at 105; Haskell, *The New West German Law of "Related Business Units"*, 24 BUS. LAW. 421 (1969); ICC 263, *supra* note 166, at 36-37.

387. AktG §§ 20-21 (1965).

results in severe consequences: the controlling shareholder's rights in the issuer company are suspended.³⁸⁸ These disclosure requirements apply to any MNE that holds the requisite percentage of shares of a German stock company.³⁸⁹

Beyond the disclosure requirements, the substantive rules of related entities may also be relevant to the MNE. Of course, the MNE is affected by German law to the extent that an MNE's operations in Germany involve a group of companies related because of stock ownership. But, when a non-German company is a party to a contract of control with a German stock company, it has been suggested that the Konzernrecht may be applied since the German company is subject to the direction of a related (although in this instance foreign) company.³⁹⁰ Such a situation raises very interesting questions since when this control agreement is present, the very dangers of subverting the interests of the subsidiary in favor of the controlling entity—concerns that prompted the passage of the Konzernrecht—exist. Will the German law permit the subsidiaries to comply with directives from an American parent corporation, which is required by the United States government to comply with American economic regulations and policies, under the theory that it promotes the interest of the MNE as a whole? Will, for example, German law recognize the attempted extraterritorial application of American antitrust laws or prohibitions against trading with an enemy of the United States? Perhaps the Germans will carefully balance the interests of the subsidiary, its shareholders, and creditors with the economic consequences to the MNE of noncompliance with American laws.³⁹¹ But, in *Fruehauf v. Massardy*,³⁹² a French court took into account only the interests of the French subsidiary and compelled it to fulfill a contract although the subsidiary had been ordered not to do so by its American parent. The conflict arose in circumstances not unlike the

388. AktG §§ 20-21 (1965).

389. AktG §§ 20-21 (1965). H. KOPPENSTEINER, *INTERNATIONAL UNTERNEHMEN DEUTSCHEN GESSELLSCHAFTSRECHT* 285 (1971) [hereinafter H. KOPPENSTEINER]. There are other general rules concerning related companies, such as the limitations imposed by AktG §§ 56, 71 (1965) on the acquisition of shares by a controlled company as a means of guaranteeing that an entity does not acquire its own shares, and the voting rights provisions of AktG § 136 (1965), but they appear to apply only to German companies. See H. KOPPENSTEINER, *supra*, at 286, 291.

390. H. KOPPENSTEINER, *supra* note 389, at 309-21.

391. *Id.* at 319; Rehinder, *The Foreign Direct Investment Regulations: A European Legal Point of View*, 34 *LAW & CONTEMP. PROB.* 95 (1969) [hereinafter Rehinder].

392. [1968] D.S. Jur. 147, [1965] J.C.P. II 14,274 bis (Cour d'appel Paris).

above hypothetical questions: The French subsidiary was supplying products to Red China—acts permitted under French law but counter to American regulations under the Trading with the Enemy Act.³⁹³

This sensitive area of conflicting national policies and the reach of economic regulatory controls of nation-states is particularly appropriate for intergovernmental cooperation and resolution. The premise of the Konzernrecht, that the needs of the business enterprise must be balanced with the protection required by creditors and minority stockholders of the subsidiary, may serve as the underlying rationale of an international agreement. Thus, reasonable limitations could be placed on the nature and scope of a parent's directives, or a method of compensation for affected groups in the host country could be designed for those occasions when the interests of the subsidiary and the MNE do not coincide.

The issues raised by German-based MNEs are less difficult; it has been suggested that most of the specific provisions directed toward related entities will not be applicable because foreign subsidiaries—not German subsidiaries—will be affected by the actions of German-based MNEs.³⁹⁴ Whether the interests of those subsidiaries will be protected in other countries will depend on the internal laws of those other countries, including, for example, such doctrines as fiduciary duties and liabilities of majority stockholders under American case law.

2. *The Proposals for a European Company Law*

A notable attempt to recognize the multinational commercial enterprise as a single legal entity in a regional context is the

393. In reaching its decision to appoint a temporary administrator to perform the contract, the court emphasized that the contract was with an exporter who, under French law, would have been able to recover treble damages for the breach of contract against Fruehauf-France, putting it out of business and destroying 600 jobs in the process. The contract was performed and the subsidiary was returned to its owners. The court did not base its decision on public or private international law; nor did it find that the United States had exceeded its jurisdiction in applying its Trading with the Enemy Act; nor did it attempt to evaluate the American interests vis-à-vis the French interests in relation to the issues at stake. Apparently the decision was solely based on concepts of French corporation law. See Craig, *Application of the Trading with the Enemy Act to Foreign Corporations Owned by Americans: Reflections on Fruehauf v. Massard*, 83 HARV. L. REV. 579 (1970).

Compare *Fruehauf* with Judgment of Dec. 21, 1960, 34 BGHZ 169, in which the German Federal Court held the American embargo policy to be in concurrence with West German policy. See Reh binder, *supra* note 391, at 111.

394. H. KÖPPENSTEINER, *supra* note 389, at 266,

"European Company" concept. Proposals for a supranational company law in Europe have been under consideration by the EEC as a means to encourage the extension of companies across national borders. It appears to be in the common interest of all members of the EEC to facilitate the growth of business operations on a larger and more efficient scale than has been possible to date under the operation of nation-based company laws.³⁹⁵ In March 1965, France submitted a memorandum to the EEC Commission suggesting the creation of commercial companies on a European scale.³⁹⁶ One year later, the EEC published a memorandum describing three alternatives that would give impetus to the creation of such companies: harmonization of the corporate laws of the EEC member nations; a uniform European company law to be introduced in all EEC member nations separately; and, a convention allowing establishment of such companies under a supranational law.³⁹⁷

The EEC invited Professor Sanders of Rotterdam to draft a statute embodying the third alternative. Although the draft,³⁹⁸ dealing solely with company law and not with the laws of related fields such as taxation, was finished late in 1966, it was not until June 1970, that the Commission submitted the proposed Law for European Companies to the Council of Ministers; the draft submitted contained the Commission's refinement of the Sanders draft, including rules of tax law.³⁹⁹ The current proposal is by no means final, and

395. See E. STEIN, *supra* note 147, at 364-87; EUROPEAN FREE TRADE ASSOCIATION, COMPANY LAW 13-17 (1970) [hereinafter COMPANY LAW]; EEC Commission Memo, No. P-1/66, Concentration of Enterprises in the Common Market, [1965-1969 New Developments Transfer Binder] CCH COMM. MKT. REP. ¶ 9081 (Jan. 1966). See also EEC Commission Press Release No. I.P. (70) 148, U.S. Investments in the EEC, Aug. 18, 1970, & Paper from documentation européenne 1970, Série Syndicate européenne, No. 9 [New Developments] 2 CCH COMM. MKT. REP. ¶ 9387, at 8841; EEC Press Release, April 1, 1970, Outline for Common Market's Industrial Policy [New Developments] 2 CCH COMM. MKT. REP. ¶ 9354.

396. French Proposal for a European Type Company, 1966 REV. TRIM. DROIT EUR. 409. An English translation appears in [1965-1969 New Developments Transfer Binder] CCH COMM. MKT. REP. ¶ 9025 (May 25, 1965) [hereinafter French Proposal].

397. EEC Commission Memo, A European-Type Company, 1966 Bull. E.E.C. Supp. 9/10, [1965-1969 New Developments Transfer Binder] 2 CCH COMM. MKT. REP. ¶ 9100 (May 3, 1966).

398. P. SANDERS, EUROPEAN STOCK CORPORATION (transl. CCH 1969) [hereinafter Sanders Draft].

399. See PROPOSED STATUTE FOR THE EUROPEAN COMPANY, 3 Bull. E.E.C. (Supp. Aug. 1970) [hereinafter PROPOSED STATUTE]. See generally E. STEIN, *supra* note 147, at 424-82; COMPANY LAW, *supra* note 395, at 13-17; Ficker, *A Project for a European Corporation*, 1970 J. BUS. L. 156, 1971 *id.* 167; Fornaiser *Toward a European Company*, 4 COLUM. J. WORLD BUS., Sept.-Oct. 1969, at 51; Mann, *The European Company*, 19 INTL. COMP. L.Q. 468 (1970); Sanders, *The European Company on Its Way*, 8 COMM. MKT.

further changes are expected.⁴⁰⁰ Although the European company (*Societas Europaea*, "S.E.") creates some problems that make it inapplicable to all MNEs, many MNEs would find it desirable to operate in the EEC in this novel business form. In addition, the adoption of this corporate form might serve as the impetus for further development of laws responsive to MNEs in general and as a model law for legislatures in their consideration of further alignment of the corporation laws of the EEC members.⁴⁰¹ The form of company contemplated by the European company proposal would be truly supranational. The company would register with the European commercial register at the Court of Justice⁴⁰² and would be regulated by one legal system of European corporation law.⁴⁰³ The uniformity of the interpretation and application of the law relating to European companies would be assured by the Court of Justice of the European Communities,⁴⁰⁴ which would construe the articles of association, interpret the European law, and determine relevant issues governed by the statute but not provided for expressly.⁴⁰⁵ In this respect the European company law is contrary to the French proposal that had sought uniform national laws to be interpreted primarily by domestic courts.⁴⁰⁶

The European company law addresses the range of questions ordinarily covered in a corporation statute. Access to the European company form would be provided for stock companies of a multi-

L. REV. 29 (1971) [hereinafter Sanders]; Schmitthoff, *Multinational Companies*, 1970 INTL. BUS. LAW 167; Scholten, *Company Law in Europe*, 4 COMM. MKT. L. REV. 377 (1967); Scholten, *The European Company*, 5 COMM. MKT. L. REV. 9 (1967); Storm, *supra* note 172; Storm, *Statute of a Societas Europaea*, 5 COMM. MKT. L. REV. 265 (1967); *A European Company Law in the Making—But Its Opportunity Is Questioned*, 7 COMM. MKT. 61 (1967); Note, *Merger Movements in the Common Market*, 10 VA. J. INTL. L. 119 (1969).

400. See EEC Economic and Social Committee, Industry, Research and Technology Bull. No. 164, [New Developments] 2 CCH COMM. MKT. REP. ¶ 9538 (1972).

401. See *id.* at 9202.

402. PROPOSED STATUTE, *supra* note 399, arts. 8, 11.

403. The company's legal seat must be located within the EEC. The proposal provides that the company may have several legal seats. PROPOSED STATUTE, *supra* note 399, art. 5(2). In contrast, the Sanders Draft provided for only one legal seat. Sanders Draft, *supra* note 398, § I-4(1). Article 7(2) of the PROPOSED STATUTE provides that national laws would apply to the MNEs on matters not governed by the PROPOSED STATUTE.

404. Since the law of the European company will be adopted as a "regulation" under the EEC Treaty, it will be subject to the jurisdiction of the court under section 177 of the Treaty, 298 U.N.T.S. at 76-77 (1958).

405. PROPOSED STATUTE, *supra* note 399, art. 7(1).

406. French Proposal, *supra* note 396.

national character, but not for limited liability companies.⁴⁰⁷ The S.E. would be the corporate form resulting from the merger⁴⁰⁸ of national stock companies and the form utilized for joint holding or subsidiary companies.⁴⁰⁹ European companies would also be eligible to participate in the formation of another S.E., either by merger or by establishment of a new holding company or subsidiary.⁴¹⁰ However, in every instance at least two of the founders must belong to different member states of the EEC; and the Commission formally restricted applicability of the European company form to member states of the EEC.⁴¹¹

In the internal organization of a European company, stock, issued as bearer or restricted shares,⁴¹² may be voting (one vote per share)⁴¹³ or nonvoting; however, nonvoting stock is subject to certain limitations.⁴¹⁴ The corporate management and control structure would follow the two-tier German system of a supervisory board and a board of management.⁴¹⁵ Stockholders would elect the supervisory board, and the supervisory board would in turn select the board of management.⁴¹⁶ The majority of the board of management would consist of

407. See PROPOSED STATUTE, *supra* note 399, art. 2. See text accompanying notes 189-91 *supra* for the distinction between stock companies and limited liability companies.

408. Note 2 to PROPOSED STATUTE, *supra* note 399, arts. 2 & 3 provides: "Merger by formation of a new company means, in the present context, amalgamation of two or more stock companies limited by shares to form a new legal entity. The founder companies cease to exist. [Consequently it] precludes . . . merger by takeover."

409. PROPOSED STATUTE, *supra* note 399, art. 2 reads: "Societes anonymes [or a comparable corporate form] incorporated under the law of a Member State and of which not less than two are subject to different national laws may establish an S.E. by merger or by formation of a holding company or joint subsidiary."

410. PROPOSED STATUTE, *supra* note 399, art. 3.

411. PROPOSED STATUTE, *supra* note 399, art. 2. Articles I-2(1), I-3(1) (c)-(d) of the Sanders Draft would allow corporations formed outside the EEC to act as promoters of the joint subsidiary in the form of an S.E. See E. STEIN, *supra* note 147, at 458, for the "access" problem. In practice, however, there is no significant difference. The foreign company can use a wholly owned subsidiary within the EEC or obtain the assistance of a bank, incorporated within the EEC, for the formation of the SE-joint subsidiary. Sanders, *supra* note 399, at 31.

412. PROPOSED STATUTE, *supra* note 399, art. 50. This is the practice in all of the member states except Italy.

413. PROPOSED STATUTE, *supra* note 399, art. 91(1).

414. PROPOSED STATUTE, *supra* note 399, art. 49(2). The total nominal value of these shares may not exceed the capital.

415. PROPOSED STATUTE, *supra* note 399, art. 83(c).

416. PROPOSED STATUTE, *supra* note 399, art. 63(1). See text accompanying notes 194-97 *supra*.

The EEC Commission's recently proposed Fifth Directive on Company Law

natural persons and citizens of the member states.⁴¹⁷ The principle of codetermination by workers in a European company⁴¹⁸ remains controversial; the Sanders draft proposed to continue codetermination where it already exists but not to introduce it elsewhere.⁴¹⁹ The Commission has attempted a general solution by giving the employees an option to appoint representatives to the supervisory board.⁴²⁰

The proposal also sets standards for disclosure of the company's accounts.⁴²¹ Following the pattern of the German law,⁴²² the European company law would require related companies to disclose material financial interests and to issue consolidated statements; in this manner, the economic and financial relationship between the parent and subsidiary corporations will be known to interested creditors and investors.⁴²³ These interested third parties are protected under the proposed European company law if any one of the related companies is a European company. The controlling company is subject to joint and several liability when the creditor has "endeavoured, and failed, to obtain payment of his debt from the dependent undertaking."⁴²⁴

Many of the problems underlying the European company proposal are directly attributable to the emergence of the MNE. The

Harmonization, which concerns the approximation of national corporate laws in the EEC, provides for a dual management system consisting of a supervisory board and management board. Fifth Directive, *supra* note 209.

417. PROPOSED STATUTE, *supra* note 399, art. 63(2)-(3). If the board of management consists of only one or two members, then they must all be nationals of member states. *Id.*

418. See text accompanying notes 210-33 *supra*.

419. Sanders Draft, *supra* note 398, arts. (V-1-1)-(V-1-4).

420. PROPOSED STATUTE, *supra* note 399, arts. 137-38. The employees will be entitled to one third of the members on the board but they may waive this right by a decision of two thirds of the employees. *Id.*

The Fifth Directive provides two options for employee participation in management of companies with 500 or more employees. Under one option, one third of the supervisory board would be appointed by employees. Under the other, the members of the board would be appointed by the board itself but the employees' representatives could object to an appointment thereby requiring referral of the appointment to the consideration of an independent body. Fifth Directive, *supra* note 209.

421. PROPOSED STATUTE, *supra* note 399, arts. 150-222. The rules are based on the draft directive for the harmonization of national legislation on the subject under article 54(3)(g) of the EEC Treaty, 298 U.N.T.S. 38 (1958).

422. AETG §§ 177, 325-26, 329-38 (1965).

423. PROPOSED STATUTE, *supra* note 399, arts. 150-222. The Fifth Directive also provides for shareholder protection through increased disclosure requirements and general shareholders' meetings. Fifth Directive, *supra* note 209.

424. PROPOSED STATUTE, *supra* note 399, art. 239.

focus of the proposal on the economic realities of modern commercial business, with its disregard of the nation-state corporate form, is a particularly noteworthy development.⁴²⁵ Acceptance of similar proposals by markets not as integrated as the EEC will be very difficult. Yet, other legal avenues are available on a multinational basis to such markets. International agreements and harmonization of specific regulatory rules and tax laws, which would not focus on corporation law, remain distinct possibilities.⁴²⁶

VI. CONCLUSION

Despite the fact that "[t]he multi-national corporation is an economic and political reality of the modern world,"⁴²⁷ the MNE remains without an adequate legal framework. Courts have only recently recognized the phenomenon of the MNE. As the International Court of Justice remarked in the highly controversial *Barcelona Traction*⁴²⁸ case:

Considering the important developments of the last half-century, the growth of foreign investments and the expansion of the international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of States have proliferated, it may at first sight appear surprising that the evolution of the law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane.⁴²⁹

In the area of corporation law, MNEs do present novel problems and challenges to the legal systems of nation-states in the long run. In the foreseeable future, however, concepts traditionally employed in the domestic setting can be satisfactorily applied to MNEs. Indeed, the decision of the EEC Court in the *Dyestuff* cases,⁴³⁰ by its application of the enterprise theory, stands as the prime example of the appropriate legal response to the MNE phenomenon. Under the domestically developed enterprise theory,⁴³¹ disregard of the cor-

425. See, e.g., PROPOSED STATUTE, *supra* note 399, art. 281 & note on art. 281.

426. See, e.g., COMPANY LAW, *supra* note 395, at 18-19.

427. WATKINS REPORT, *supra* note 3, at 355.

428. *Barcelona Traction Light & Power Co., (Belgium v. Spain)* [1970] I.C.J. 3, reprinted at 9 INTL. LEGAL MATERIALS 227 (1970), and summarized in 64 AM. J. INTL. L. 653 (1970).

429. [1970] I.C.J. at 34.

430. See text accompanying notes 354-68 *supra*.

431. See notes 14 & 263-89 *supra* and accompanying text.

porate entity is justified because a corporation is only a fragment of a larger enterprise that actually conducts the business under consideration. In such a case, a larger corporate entity would be held financially responsible. Similarly, in a multinational corporate structure, an individual corporate member should be disregarded in order to reach the larger entity that is actually responsible for the activity in question. That is not to say that the corporation may be disregarded for all legal purposes. The enterprise theory is applicable only to those activities that are in fact attributable to the controlling corporation because those decisions are in fact centralized in the international headquarters. Presently, MNEs have decentralized much of their decision-making from international headquarters to the national level. Such a delegation of power enables local management to adapt strategies to the market conditions of the local environment and to the demands of governmental authorities. Consequently, for most legal purposes the local corporations of the MNE should be the proper object of local legal directives. If the states do not effectively reach the appropriate unit of the MNE, national policies will be frustrated.

In sum, once legislatures and national authorities are cognizant of the organizational and control characteristics of MNEs, they can employ various legal theories to protect national interests. First, complete disregard of the corporate entity is justified in exceptional circumstances of fraud, evasion of national laws, or when a particular corporation does not fulfill substantial business functions. This extreme approach is not applicable to operating subsidiaries, but rather applies, for example, to certain intermediate holding companies typically located in tax haven countries.⁴³² Second, while the distinct entities of the multiple corporations should be recognized, certain transactions should nevertheless be attributed to the controlling corporations. The use of this approach will depend on individual circumstances and on the specific structure of the MNE in question. This partial disregard of the corporate entity is made possible by ascertaining the location of the MNE's decision-making power with respect to the issue under consideration. States must recognize that an MNE's control over its affiliates should be reflected in the treatment of these local members of the MNE, which occasionally will lead to treatment different from that accorded to local unrelated corporations. For example, tax authorities may interfere

432. See text accompanying notes 291-300 *supra*.

with the MNE's transfer price decisions in order to protect the national revenue.⁴³³ Similarly, restrictive arrangements by foreign units of the MNE that affect local competition may be prohibited,⁴³⁴ while at the same time common control over affiliates may justify approval of other intercompany restrictive arrangements that otherwise would be prohibited.⁴³⁵ Third, different criteria may be established for corporate "nationality" depending on the legal issues involved, in order to apply national policies to the proper segment of the MNE.⁴³⁶

National laws and regulations addressed to MNEs will inevitably produce implications extending beyond national boundaries that will clash with the directives or policies of other sovereign states. As a result, MNEs may be caught between contradictory policies of two or more nations. Conversely, MNEs might avoid effective legal regulation if they were to discover loopholes arising from the lack of intergovernmental cooperation and coordination in a given area. States must, therefore, cooperate with each other in reaching common understandings and international agreements to relieve tension in areas such as taxation of the MNE—particularly in regard to intercompany transactions,⁴³⁷ conflicting antitrust policies,⁴³⁸ trading with the

433. See notes 307, 317-18 & 329 *supra* and accompanying text.

434. See notes 348-68 *supra* and accompanying text.

435. See text accompanying notes 330-36 *supra*.

436. The criteria of corporate nationality will be considered in greater depth in the second Article.

437. Tax treaties should be adapted to the MNE to include rules for allocating and adjusting income as well as more satisfactory mutual agreement procedures.

438. Currently, the Organization for Economic Cooperation and Development (OECD) plays the major role in relieving the tension of international antitrust frictions. Its Committee of Experts on Restrictive Business Practices is comprised of government experts from the member states. This group exchanges antitrust information, helps to develop national laws, and has initiated the multivolume GUIDE TO WORLD LEGISLATION OF RESTRICTIVE BUSINESS PRACTICES. See J. Rahl, *supra* note 349, at 454-59. The current procedure was adopted in October 1967 by a Recommendation of the Council of the OECD Concerning Cooperation Between Member Countries on Restrictive Business Practices Affecting International Trade, OECD Doc. (C)(67)53 (Final), in J. Rahl, at 456-57. Under the procedure, a country has to notify other member states of any antitrust investigation or proceeding involving important interests of these members. Such a notification gives an opportunity to consider the view of the other members prior to any unilateral act, para. I(a). The procedure provides for exchanges of information among the members insofar as "their laws and legitimate interests permit them to disclose," para. 2.

The cooperative procedure developed by the OECD was spurred by the effective procedure in international antitrust *between the United States and Canada*. The latter cooperation emerged out of the Canadian-United States consultations with respect to the Canadian Electronic Patents case. *United States v. General Elec. Co.*, Civil No. 140-157 (S.D.N.Y. filed Nov. 24, 1958), *settled by a consent decree*, 1962 Trade Cas. ¶ 70,546 (S.D.N.Y. 1962). The same consent decrees were entered against Westinghouse, 1962 Trade Cas. ¶ 70,428 (S.D.N.Y. 1962) and Philips, 1962 Trade Cas. ¶ 70,342

enemy acts, export control regulations, securities laws, foreign investment laws, and to promote proper corporate behavior and responsibilities toward the states in which the MNE operates. Each field of law can be the subject of a separate arrangement, since it would be difficult if not impossible to develop a single arrangement capable of covering most of these issues.⁴³⁹ In addition to the attempts to reach international agreements in each area of conflict and friction, efforts should be made to establish an international forum that will allow MNEs and the competent authorities of the states to discuss the areas of conflict in order to encourage mutual understanding and to work out a procedure to solve actual conflicts.⁴⁴⁰ Until international agreements of mutual understandings are concluded, the states should individually exercise their legislative powers cautiously, in order to avoid international conflicts with or discrimination against multinational business.⁴⁴¹

At this point in time there is no pressing need for a supranational corporation law under the direction of an international institution,⁴⁴² except perhaps in regional markets such as the European Common

(S.D.N.Y. 1962). In 1959, Canada's Minister of Justice and Attorney General, David Fulton, and his United States counterpart, William Rogers, arrived at an informal agreement, called the Antitrust Notification and Consultation Procedure, designed to eliminate friction and to encourage common understanding of antitrust problems affecting the two countries. *Hearings on International Aspects of Antitrust Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 89th Cong., 2d Sess. 453 (1966). The procedure has been strengthened by a later Joint Statement, issued in November 1969, by the Canadian Minister Ron Basford and the United States Attorney General, John Mitchell. U.S. Dept. of Justice Press Release, Nov. 3, 1969 (mimeo). See J. Rahl, *supra*, at 447-48. The procedure provides for notification of antitrust proceedings affecting the other country, a consultation procedure, exchange of information of "activities or situations" affecting international trade, and, whenever possible, coordination of the enforcement of antitrust laws.

439. Thus, the proposal of an international mechanism similar to GATT applicable to all MNEs would not be feasible at this stage. See, e.g., Goldberg & Kindleberger, *supra* note 2, advocating such a procedure for international investment. Cf. Rubin, *supra* note 2, disagreeing with the idea of a GATT for investment but going too far in rejecting the need for separate international arrangements in some of the areas of conflict.

440. The current procedure concerning international antitrust conflicts between the United States and Canada under the mutual agreement procedure under bilateral tax treaties may serve as a starting point. See Hadari, *supra* note 179, at 134-35, for a discussion of agreement through tax treaties.

441. An example of a unilateral exemption designed to facilitate international business is the SEC regulation, 17 C.F.R. § 240.12g3-2 (1972), which exempts certain securities issued by foreign issuers from the disclosure requirements of section 12g of the Securities Exchange Act of 1934, 15 U.S.C. 78l(g) (1970), to the extent that disclosure of the information in question is not required or disclosed by the issuer in his country. See Buxbaum, *Securities Regulation and the Foreign Issuer Exemption: A Study in the Process of Accommodating Foreign Interests*, 54 CORNELL L. REV. 358 (1969).

442. See, e.g., Ball, *Cosmocorp: The Importance of Being Stateless*, 2 COLUM. J. WORLD BUS., Nov.-Dec. 1967, at 25.

Market. Most MNEs are not in fact truly multinational,⁴⁴³ but rather are still identified with their home countries; it is not anticipated that such enterprises are ready to incorporate internationally. Moreover, the conflict among corporation laws on the international level has not reached the stage at which multinational investments are significantly impeded. Consequently, states have not yet moved to reach an innovative multinational agreement, since it is not yet a priority item. If, however, the European company proposal is effectuated successfully, it may provide a new stimulant to the concept of a world company. Future developments in the European Common Market should be monitored carefully, especially with the admission of the United Kingdom and Ireland, which may lead to greater harmonization of civil and common law.

443. See text accompanying notes 67-73 *supra*.